Supreme Court, U.S.
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No. 90-1278

In the Supreme Court of the United States

OCTOBER TERM, 1990

INDOPCO, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED FEBRUARY 11, 1991
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276 pgs.

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RELEVANT DOCKET ENTRIES

United States Tax Court

09/07/84	Petition filed.
11/06/84	Answer filed.
03/18/86	Motion by petitioner for summary judgment filed.
05/30/86	Motion by respondent for summary judgment filed.
10/20/86	Order filed denying petitioner's motion for summary judgment (filed 03/18/86) and respondent's motion for summary judgment (filed 05/30/86).
12/04/86	Amendment to answer filed.
06/16/87	Trial before Judge Clapp.
06/16/87	Stipulation of facts with attached exhibits filed.
06/16/87	Supplemental stipulation of facts with attached exhibits filed.
07/24/89	Findings of Fact and Opinion of Judge Clapp issued.
07/26/89	Decision for respondent entered.
10/20/89	Notice of appeal filed.
10/20/89	Bond in the amount of $2,150,000 issued by Seaboard Surety filed.

United States Court of Appeals for the Third Circuit

03/16/90	Oral argument held.
11/13/90	Opinion affirming judgment of Tax Court issued; judgment entered.
11/28/90	Order entered amending 11/13/90 opinion by deleting footnote.
12/03/90	Motion by appellant to stay mandate filed.
12/19/90	Order granting motion to stay mandate to and including 02/11/91 filed.

United States Supreme Court

02/11/91	Petition for writ of certiorari filed.
04/30/91	Brief for respondent filed.
05/13/91	Petition for writ of certiorari granted.

UNITED STATES TAX COURT

NATIONAL STARCH AND CHEMICAL CORPORATION Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	)	Docket No. 31669-84

PETITION

(Filed September 7, 1984)

The Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (bearing symbols A:Nwk:NBB:GT:90D) dated June 12, 1984, and for a determination of an overpayment of Federal income tax, and as the basis for its case alleges as follows:

1. The Petitioner is a corporation organized and existing under the laws of the State of Delaware, having its principal office at 10 Finderne Avenue, Bridgewater, New Jersey 08807. The Petitioner's employer identification number is 13-1522451. The return for the period here involved was filed with the Office of the Internal Revenue Service at Holtsville, New York.

2. The notice of deficiency (a copy of which, including so much of the statement and schedules accompanying the notice as is material, is attached and

marked Exhibit A) was issued by the Office of the Internal Revenue Service at Newark, New Jersey, and was mailed to the Petitioner on June 12, 1984.

3. The deficiency as determined by the Commissioner is in income taxes for the taxable period ended August 15, 1978, in the amount of $1,068,281.00 all of which is in dispute. In addition, Petitioner claims that it made an overpayment of income tax in the amount of $338,918 for such taxable period.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Respondent erred in determining that the payment of $2,225,586.00 to Morgan Stanley and Company, Incorporated ("Morgan Stanley") for professional advisory fees represents a capital expenditure and, therefore, is not deductible as an ordinary and necessary business expense.

(b) The Respondent erred in failing to reduce the income tax liability of Petitioner for the taxable period ended August 15, 1978 for certain expenses totalling $706,079 for legal fees, auditors' fees, printing costs of a proxy statement, proxy solicitation expenses, employee compensation consultants' fees and SEC filing and other fees, all of which were incurred by Petitioner in connection with a transaction whereby Petitioner was acquired by another company and which are deductible as ordinary and necessary business expenses but were improperly capitalized by Petitioner as reflected in Schedule M of its income tax return for such period.

5. The facts upon which the Petitioner relies, as the basis of its case, are as follows:

(a) In October, 1977, Unilever United States Inc. ("Unilever") approached the management of Petitioner, as well as its two largest shareholders, Anna A. and Frank K. Greenwall (the "Greenwalls"), to express an interest in acquiring the stock of Petitioner.

(b) Soon thereafter, the management of Petitioner informed its Board of Directors of the Unilever expression of interest in acquiring the stock of Petitioner and of the Greenwalls' disposition toward a favorable response.

(c) The Board decided that it should not proceed to consider its response to the Unilever expression of interest in acquiring the stock of Petitioner without first obtaining the advice of an independent investment banking firm.

(d) On or about November 14, 1977, Petitioner engaged the services of Morgan Stanley, confirmed by a letter of December 6, 1977, to review the situation arising from the Unilever expression of interest in acquiring the stock of Petitioner and advise the officers and directors of Petitioner as to appropriate courses of action in response to such expression of interest by Unilever.

(e) Retaining the advice of a qualified investment banking firm is, and was at the time that Morgan Stanley was hired by Petitioner, a common and prudent practice for the officers and directors of a potential target company when faced

with an unsolicited bid for acquisition of a controlling interest in its stock.

(f) Pursuant to the retention of the services of Morgan Stanley, the officers and directors of Petitioner consulted with and received the advice of Morgan Stanley regarding the acquisition of the stock of Petitioner by Unilever.

(g) On or about March 16, 1978, the Board of Directors of Petitioner approved the terms of an agreement and plan of merger whereby Unilever would indirectly acquire the stock of Petitioner in a reverse subsidiary merger. The plan called for Unilever to create a subsidiary holding company, National Starch and Chemical Holding Corporation ("Holding") which, in turn, would create a wholly-owned second-tier subsidiary, NSC Merger, Inc. which would merge into Petitioner, with the shareholders of Petitioner receiving cash for their shares.

(h) In July 1978, a proxy statement was sent to the shareholders of record of Petitioner informing them of a special meeting to be held to vote on the plan of merger.

(i) Attached to the proxy statement sent in July 1978 to shareholders of record of Petitioner was an offer by Holding to exchange shares of nonvoting preferred stock of Holding for shares of stock of Petitioner.

(j) The Board of Directors of Petitioner recommended that the shareholders vote in favor of the merger and included in the proxy materials the opinion of Morgan Stanley, rendered to the Board,

that the offer to the shareholders was fair and equitable.

(k) In August 1978, the shareholders approved the merger.

(l) On or about August 15, 1978, the merger was consummated with over 80% of the stockholders receiving cash in exchange for their shares in Petitioner, the remainder of the shareholders of Petitioner having elected to exchange their shares for shares of preferred stock of Holding pursuant to the exchange offer.

(m) The transaction, though a merger in form, was in substance a purchase by Holding, a subsidiary of Unilever, of Petitioner's stock for cash or preferred stock of Holding.

(n) As the target corporation whose stock was acquired, Petitioner neither acquired nor enhanced any asset as a result of the transaction.

(o) The services performed by Morgan Stanley consisted of (i) advice to and consultation with the officers and directors of Petitioner to assist them in responding to the unsolicited offer of Unilever and in deciding whether to approve or disapprove the plan of merger and to recommend such approval or disapproval to the shareholders and (ii) the rendering of an opinion, in support of the decision of the Board of Directors of Petitioner to approve the plan of merger, that the terms of Unilever's offer were fair and equitable.

(p) The Board of Directors had Petitioner engage the services of Morgan Stanley in order to protect, rather than acquire, property and to as-

sist the officers and directors of Petitioner in the proper discharge of their fiduciary obligation to Petitioner's shareholders.

(q) The Morgan Stanley fee was both an ordinary and a necessary expense of Petitioner.

(r) Petitioner incurred expenses totalling $706,079 for legal fees, auditors' fees, printing costs of the proxy statement, proxy solicitation expenses, employee compensation consultants' fees and SEC filing and other fees, all in connection with the plan of merger, which it expensed on its books of account but which were capitalized for Federal income tax purposes as reflected in Schedule M of its return.

(s) The expenses referred to in paragraph (r) did not create or enhance an asset of Petitioner.

(t) The expense referred to in paragraph (r) were both ordinary and necessary expenses of Petitioner.

(u) A claim for refund for an overpayment of income tax resulting from the capitalization rather than deduction of the expenses referred to in paragraph (r) has not been filed. However, had such a claim been filed on the date of the mailing of the notice of deficiency, the claim would have been timely.

WHEREFORE, Petitioner prays that this Court may hear its case, determine that there is no deficiency in Federal income tax due from the Petitioner for the taxable period ended August 15, 1978, determine that an overpayment of income tax in the amount of $338,918 was made for such taxable period and grant

Petitioner any other and further relief to which it may be entitled.

(Signatures omitted in printing)

UNITED STATES TAX COURT

(Caption omitted in printing)

ANSWER

(Filed November 6, 1984)

THE RESPONDENT, in answer to the petition filed in this case, admits and denies as follows:

1. through 3. Admits

4. (a) and (b) Denies.

5. (a) through (n) Denies for lack of sufficient present knowledge.

(o) through (q) Denies.

(r) Denies for lack of sufficient present knowledge.

(s) and (t) Denies.

(u) Denies for lack of sufficient present knowledge.

6. Denies generally each and every allegation of the petition not hereinbefore specifically admitted, qualified or denied.

WHEREFORE, it is prayed that the deficiency determined by the respondent be in all respects approved.

(Signature and certificate of service omitted in printing)

UNITED STATES TAX COURT

(Caption omitted in printing)

AMENDMENT TO ANSWER

(Filed December 12, 1980)

THE RESPONDENT, for an Amendment to Answer filed in the above-entitled case, adds after paragraph 6. of the Answer and prior to the prayer, the following paragraph:

7. FURTHER ANSWERING the petition, the respondent herewith notifies the petitioner that he is relying upon the additional theory for disallowance of the claimed deduction for amounts paid to Morgan Stanley & Co. and any "Ancillary Expenses" claimed as additional deductions in the petition that these expenditures are not deductible by petitioner because they were made primarily for the benefit of petitioner's shareholders and therefore are not "ordinary and necessary" within the meaning of I.R.C. §162.

WHEREFORE, it is prayed that the deficiency determined by the respondent be in all respects approved.

(Signature omitted in printing)

UNITED STATES TAX COURT

(Caption omitted in printing)

STIPULATION OF FACTS

(Filed June 16, 1987)

In accordance with Tax Court Rule 91, it is hereby agreed by and between the parties hereto that for purposes of this case the following facts are to be considered true and correct, subject to the terms of this preamble. All stipulated facts shall be treated as conclusive admissions. All stipulated exhibits shall be considered authentic. The truth of assertions within stipulated exhibits may be rebutted or corroborated by additional evidence. All copies of documents shall be treated as if they were the original documents. Any evidentiary objections that are not specifically expressed within this stipulation may be made in accordance with Tax Court Rule 91.

1. Petitioner is a corporation organized and existing under the laws of the State of Delaware. During the period in issue and at the time of the filing of the petition herein, Petitioner had its principal office in Bridgewater, New Jersey. It uses the accrual method of accounting for Federal income tax purposes. Its Federal income tax return for the period from January 1 to August 15, 1978 ("1978 fiscal year"), was filed with the Internal Revenue Service Center in Holtsville, New York. A copy of such return (Form 1120 and supporting schedules and attachments) is attached as Exhibit 1-A.

2. By statutory notice dated June 12, 1984 (a copy of which is attached as Exhibit 2-B), Respondent

determined a deficiency in Petitioner's income tax for its 1978 fiscal year in the amount of $1,068,281.

3. Petitioner has been and is engaged in the manufacture and sale, primarily for industrial use, of adhesives, starches and specialty chemical products in the United States and certain foreign countries. Immediately prior to August 15, 1978, Petitioner's authorized capital stock consisted of 250,000 shares of preferred stock, no par value, none of which was issued or outstanding, and 8,000,000 shares of common stock, par value $.50 per share, approximately 6,563,930 shares of which were issued and outstanding. Petitioner's common stock was then publicly held (by approximately 3,700 shareholders of record) and was actively traded on the New York Stock Exchange. Petitioner's directors, officers and their families held about 25 percent of Petitioner's common stock and about 75 percent of Petitioner's common stock was held by the public. Copies of the 1977 and 1978 Annual Reports of Petitioner are attached as Exhibit 3-C.

4. Unilever United States, Inc. ("Unilever U.S."), is a corporation organized and existing under the laws of the State of Delaware, with its principal office in New York City. It is a holding company, the principal subsidiaries of which, immediately prior to August 15, 1978, were Lever Brothers Company and Thomas J. Lipton, Inc. Those two corporations have been and are engaged principally in the manufacture and sale in the United States of foods, tea and other drinks, detergents and toilet preparations. All the outstanding stock of Unilever U.S. is owned by Unilever N.V., a publicly held Netherlands corporation which, together with Unilever PLC, a publicly held United Kingdom corporation, and companies directly or indirectly

owned or controlled by them, comprise the Unilever Group. The Unilever Group has been and is engaged in the manufacture and sale in the United States and many foreign countries of a wide variety of goods for common household use. A copy of the 1977 Annual Report of Unilever N.V. is attached as Exhibit 4-D.

5. On August 15, 1978, National Starch and Chemical Holding Corporation ("Holding"), a Delaware subsidiary of Unilever U.S. organized for the purpose, acquired all the outstanding common stock of Petitioner in exchange for 1,313,383 shares of preferred stock of Holding with an aggregate par value of $96,533,650 and $380,151,075 in cash. One hundred seventy-nine shareholders, holding approximately 21 percent of Petitioner's common stock, voluntarily exchanged their stock on a share-for-share basis for the Holding preferred stock, having a par value of $73.50 per share, and the common stock of Petitioner held by its other shareholders was exchanged for $73.50 per share in cash. Petitioner thereupon became an indirect wholly owned subsidiary of Unilever U.S. and a member of its affiliated group for Federal income tax purposes. A copy of an Amended Final Report dated August 15, 1978, by the Depository Agent (Morgan Guaranty Trust Company of New York) reflecting those of Petitioner's shareholders (or their designated nominees) that accepted the Exchange Offer is attached as Exhibit 5-E.

6. The acquisition of Petitioner's stock by Holding as described in paragraph 5 above was accomplished pursuant to an Exchange Offer dated July 10, 1978 ("the Exchange Offer"), in which Holding offered to issue its preferred stock in exchange for any amount of Petitioner's common stock, and an Agree-

ment and Plan of Merger dated as of March 16, 1978 (the "Merger Agreement"), which provided for a conversion into cash of any common stock of Petitioner that was not acquired by Holding pursuant to the Exchange Offer. Such cash was contributed by Unilever U.S. to Holding and then by Holding to its newly formed subsidiary, which was merged into Petitioner pursuant to the Merger Agreement. Copies of the Exchange Offer and the Merger Agreement are attached as Exhibits 6-F and 7-G, respectively.

7. The use of a merger under Delaware law as described above, referred to as a "reverse subsidiary cash merger," assured Unilever U.S., if the merger was approved by two-thirds of Petitioner's shareholders, of obtaining 100 percent of the common stock of Petitioner.

8. Prior to the acquisition of Petitioner's stock by Holding, the Internal Revenue Service (the "IRS") issued a ruling letter dated June 28, 1978 (a copy of which is attached as Exhibit 8-H), which held, in part, that for Federal income tax purposes Petitioner's shareholders that accepted the Exchange Offer and received Holding preferred stock for common stock of Petitioner should treat the transaction as a tax-free exchange under Section 351 of the Internal Revenue Code while those shareholders of Petitioner that received cash for their shares should treat the transaction as a taxable purchase of their common stock of Petitioner by Holding for cash, the formation of Holding's subsidiary and its merger into Petitioner being disregarded.

9. After the acquisition of Petitioner's stock by Holding, the management and business operations of

Petitioner, its subsidiaries and joint ventures were continued as theretofore. Petitioner's directors and officers remained in office and its key officers and employees executed employment contracts with Petitioner as required by the Merger Agreement. Petitioner did not by virtue of the acquisition of its stock acquire any property or services from any member of the Unilever Group. No property or assets of Petitioner were sold or otherwise disposed of by virtue of the acquisition of its stock. Nothing herein shall preclude the Respondent from contending that Petitioner's affiliation with Unilever (a consequence of the acquisition of its stock) resulted in the acquisition of an intangible asset. Petitioner's capital structure, both debt and equity, remained unchanged, except that, pursuant to the Merger Agreement, Petitioner's Certificate of Incorporation was amended to eliminate its previously authorized shares of preferred stock and to reduce the total number of its authorized shares of common stock to 1,000, par value $1 per share. Copies of the Restated Certificate of Incorporation of Petitioner filed May 6, 1970, the Restated Certificate of Incorporation of Petitioner dated August 16, 1978, and the Restated Certificate of Incorporation of Holding filed August 14, 1978, are attached as Exhibits 9-I, 10-J and 11-K, respectively.

10. The acquisition of Petitioner's stock on August 15, 1978, was preceded by discussions between Petitioner and Unilever U.S. In such discussions, Unilever U.S. was represented by the investment banking firm of Lazard Freres & Co. ("Lazard"). The law firm of Debevoise, Plimpton, Lyons & Gates ("DPL&G"), which had been legal counsel to Petitioner for many years, acted as legal counsel to Petitioner in

connection with the discussions and the documentation and implementation of the transaction. The law firm of Cravath, Swaine & Moore ("CS&M") acted as legal counsel to Unilever U.S. in such connection.

11. The discussions were initiated on October 7, 1977, when the Unilever Group, through Lazard, indicated that it was interested in acquiring 100 percent of Petitioner's stock. Felix Rohatyn, a partner of Lazard, met, at Mr. Rohatyn's request, with Frank K. Greenwall (who was Chairman of the Executive Committee of Petitioner's Board of Directors and who, together with his wife, Anna A. Greenwall, owned approximately 14-1/2 percent of Petitioner's outstanding common stock) and Donald D. Pascal, Chairman of Petitioner's Board of Directors, and indicated that the Unilever Group was looking at a number of U.S. companies, including Petitioner, with the possibility of acquisition in mind. This was the first time that either Mr. Greenwall or Mr. Pascal was aware of such an interest. Mr. Rohatyn asked whether Mr. Greenwall would be willing to discuss the possibility of a cash sale of Petitioner's shares by Mr. Greenwall and his wife to Unilever U.S. as part of an acquisition of all of Petitioner's shares by Unilever U.S. Mr. Rohatyn indicated that Unilever U.S. was not thinking of an "unfriendly" tender situation and would proceed with discussions only if the Greenwalls were willing to sell their shares and, in that event, only if Petitioner favored the acquisition. Mr. Greenwall told Mr. Rohatyn that he would give the question some thought.

12. At the time of the transaction at issue, Frank K. Greenwall was 81 years of age and his wife was 79 years of age. Prior to serving as Chairman of

the Executive Committee of Petitioner's Board of Directors, Mr. Greenwall had served as Petitioner's President and Chairman of the Board of Directors. The Greenwalls' tax basis for their common stock of Petitioner was less than $15.00/share. Mr. and Mrs. Greenwall were shareholders of Petitioner for many years prior to the initial public offering of Petitioner's common stock.

13. After consulting with his legal advisors (the firm of DPL&G, which had also represented Mr. Greenwall and his wife for a number of years) and his accountant, Mr. Greenwall indicated that, because of estate planning considerations, he and his wife would voluntarily dispose of their shares only in a tax-free transaction that would be available to other shareholders of Petitioner that so desired. Thereafter, during mid-October through early November 1977, CS&M and DPL&G met a number of times to discuss possible mutually acceptable structures to make a tax-free transaction available in the overall context of a stock acquisition for cash. A structure was proposed by CS&M, the basic elements of which are described in paragraph 6 (the "Structure"). The Structure was discussed with DPL&G, and later it was decided to explore with representatives of the IRS in the Rulings Branch in Washington whether the contemplated Structure would be acceptable to the IRS.

14. On November 3, 1977, CS&M and DPL&G met with IRS officials in the Rulings Branch of the National Office in Washington at a presubmission conference. At that meeting the Structure that had been devised was discussed.

15. On November 7, 1977, after a regular meeting of Petitioner's Board of Directors, the directors were informed of the inquiry on behalf of Unilever U.S. and the proposed Structure for an acquisition of Petitioner's stock by a subsidiary of Unilever U.S. The directors decided that no further steps on a decision as to a possible acquisition would take place unless the proposed Structure was satisfactory, and that if it appeared that the proposed Structure was satisfactory, no negotiations should be conducted or decision on terms reached without advice from an independent investment banking firm.

16. On November 14, 1977, Petitioner engaged Morgan Stanley and Co. Incorporated ("Morgan Stanley") to assist and advise Petitioner's Board of Directors. Morgan Stanley was (and continues to be) a leading investment banking firm in the United States and often is involved in representing companies like Petitioner in connection with similar proposed transactions. By letter dated December 6, 1977 (a copy of which is attached as Exhibit 12-L), Morgan Stanley provided a description of its approach to matters of this nature and a schedule of the fees that it charged for its services. By letter dated the same date (a copy of which is attached as Exhibit 13-M), Petitioner confirmed Morgan Stanley's engagement.

17. To carry out its engagement by Petitioner, Morgan Stanley assigned a team of four people from its Mergers & Acquisitions Department to deal with

the project (titled "Project Buttondown"). The team consisted of the following persons:

Robert F. Greenhill - Managing Director

R. Bradford Evans - Vice President

Dennis Haydon - Associate

Karen Flannery - Analyst

18. As an initial matter, prior to rendering any advice, the Morgan Stanley team undertook a careful and detailed review of Petitioner, its business, its shareholders and market trends with the object of fixing a range of values at which an offer from Unilever U.S. would be acceptable from a financial point of view. The team also analyzed the proposed Unilever U.S. transaction (as it had been developed to that point) and considered whether there was any potential interest by other parties in Petitioner. During early December 1977, Morgan Stanley also met with DPL&G and with Lazard with respect to the proposed Structure and the terms of the restrictive covenants for inclusion in Holding's Certificate of Incorporation.

19. The Morgan Stanley team findings were summarized in a report (a copy of which is attached as Exhibit 14-N) and were discussed with other Morgan Stanley personnel in the Mergers & Acquisitions Department and related areas to ensure as broad a consensus within the firm as possible. Thereafter, Mr. Greenhill discussed the findings with representatives of Petitioner and obtained its authorization to ascertain from Unilever U.S. the amount that Unilever U.S. might be willing to offer for Petitioner's stock and the terms under which an offer might be made.

20. During early December, 1977, Mr. Greenhill (assisted by R. Bradford Evans) carried on discussions, under the direction and control of Petitioner, with Mr. Rohatyn and Peter Jacquith of Lazard regarding the value that Unilever U.S. would be willing to offer for each share of Petitioner's common stock. The discussions culminated in an offer by Unilever U.S. of $73.50 per share for Petitioner's stock. This value was a compromise reached between the value sought by Petitioner and that offered by Unilever U.S.

21. On December 11, 1977, a special meeting of Petitioner's Board of Directors was held at which Morgan Stanley submitted an oral report on the results of its evaluation of the Unilever U.S. offer of $73.50 per share. This oral report was accompanied by a document entitled "Project Buttondown" (a copy of which is attached as Exhibit 15-O), which contained 26 exhibits summarizing the results of Morgan Stanley's work. At such meeting, after taking into account Morgan Stanley's report, Petitioner's Board of Directors approved the form of a letter of intent relating to the acquisition of Petitioner's common stock by Unilever U.S., and on the same date the Letter of Intent (a copy of which is attached as Exhibit 16-P) was executed by Petitioner and Unilever U.S. At the meeting there was also elected a special committee of the Board comprised of three outside directors, designated as the Merger Committee of the Board of Directors, to supervise the investigations contemplated by and to assist in the negotiations relating to the carrying out of the Letter of Intent and to advise the Board of the outcome of such investigations. A copy of the minutes of the meeting is attached as Exhibit 17-Q. A copy of Morgan Stanley's presentation outline for the Decem-

ber 11, 1977, Board of Directors meeting is attached as Exhibit A. Petitioner stipulates only that Exhibit A is an authentic copy of a document prepared by Morgan Stanley but does not stipulate as to the truth of the contents and reserves all other evidentiary objections.

22. Subsequent to the execution of the Letter of Intent and prior to the execution of the Merger Agreement, Morgan Stanley performed a due diligence review of Petitioner and the Unilever Group that involved a detailed investigation of the facts necessary to update and support its opinion regarding the transaction. Morgan Stanley also assisted the Merger Committee of Petitioner's Board of Directors in finalizing the terms of the preferred stock of Holding and assuring that the financial aspects of the transaction did not result in unequal treatment among Petitioner's shareholders. In this regard, Morgan Stanley also participated by briefing Petitioner's Board of Directors and reviewing the proposed merger documents, proxy and prospectus drafts, employment contract drafts and proposed ruling request. Representing some of the work performed by Morgan Stanley are copies of the following items attached as exhibits as indicated:

Description	*Exhibit*
– 12/20/77 "List of Major Due Diligence Considerations"	B
– 12/22/77 letter (Dennis Haydon) to DPL&G (K.L. Wallach) re Due Diligence Inquiries	C

– 1/8/78 Memorandum re Agenda for Due Diligence session with Unilever management	D
– 1/22/78 Memorandum re Initial Due Diligence Session with Petitioner's Management	E
– 2/5/78 Outline for Briefing of Petitioner's Board of Directors	F
– 2/6/78 Memorandum from D.R. Haydon to Project Buttondown Team re Meeting with Petitioner's Board of Directors	G

Petitioner stipulates only that these documents are authentic copies of items prepared by Morgan Stanley, but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

23. A written ruling request concerning the proposed structure of the transaction was submitted by DPL&G to the IRS by letter dated January 6, 1978 (a copy of which, together with supplemental submissions dated March 23 and June 7, 1978, is attached as Exhibit 18-R), and, as indicated in paragraph 8 above, in response to such request a favorable ruling on the proposed structure was issued by the IRS by letter dated June 28, 1978.

24. By February, 1978, agreement on the definitive terms of the Merger Agreement and Exchange Offer had been reached and Morgan Stanley had completed its due diligence reviews of the transaction as proposed and of Petitioner and Unilever U.S. At this point, prior to Petitioner's Board of Directors executing the Merger Agreement and Morgan Stanley's

recommendation to the Board of Directors on whether to do so, the Morgan Stanley project team again presented its findings to other personnel in the Mergers & Acquisitions Department and related areas and solicited their views. A briefing outline and summary memorandum were prepared for use at the meeting. Copies of the following documents regarding the Morgan Stanley February, 1978 "firm meeting" on this matter are attached as exhibits as indicated:

Description	Exhibit
– 2/12/78 Meeting Notice	H
– Presentation Outline for 2/21/78 Firm Meeting	I
– "Project Buttondown" Summary Memorandum (w/Exs "A" - "F")	J
– 2/16/78 Memorandum to Dennis Haydon from W.F. Kroener, III, Esq. of Davis Polk & Wardwell (Morgan Stanley's counsel) re "Meaning of 'Equitable' in Valuation Opinion"	K

Petitioner stipulates only that these documents are authentic copies of items prepared by Morgan Stanley but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

25. The project team's opinion and findings were approved at the Merger & Acquisitions "firm meeting" and thereafter Mr. Greenhill presented the opinion and findings at the meeting of Petitioner's Board of Directors held on March 16, 1978, to consider whether to execute the Merger Agreement with Unilever U.S.

that had been finalized and approve the preliminary drafts of the proxy statement that had been prepared for use in soliciting shareholder approval once the ruling from the Internal Revenue Service had been obtained. After Morgan Stanley updated its previous reports by informing the Board of Directors that it had conducted an investigation to determine whether any change in circumstances had occurred that would cause it to alter its prior conclusion and found no such change, the Board of Directors approved the execution of the Merger Agreement. Copies of the following items relating to the March 16, 1978, NSC Board Meeting are attached as exhibits as indicated:

Description	Exhibit
Minutes of Meeting of Petitioner's Board of Directors held 3/16/78 (w/various draft agreements attached)	19-S

26. As indicated in paragraph 8 above, on June 28, 1978, the IRS issued a favorable ruling regarding the transaction as proposed. On the same day, the Executive Committee of Petitioner's Board of Directors met in special session and resolved that a Special Stockholder's Meeting be held on August 15, 1978, to vote on the Merger Agreement.

27. Prior to submission of its written opinion for inclusion in the proxy materials, the Morgan Stanley project team sought further internal review of its findings from its Mergers & Acquisitions Review Committee. A copy of a Morgan Stanley memorandum dated July 7, 1978, from the project team to the Mergers & Acquisitions Review Committee is attached as Exhibit L. Petitioner stipulates only that Exhibit L is an

authentic copy of a document prepared by Morgan Stanley but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections. The Review Committee approved the team's findings and authorized the delivery of Morgan Stanley's written opinion to Petitioner's Board of Directors.

28. On July 10, 1978, a Special Meeting of Petitioner's Board of Directors was held. At the meeting Mr. Greenhill updated the firm's prior reports and delivered a Morgan Stanley letter dated July 10, 1978 (a copy of which is attached as Exhibit 20-T), expressing its opinion on the fairness of the proposed Unilever U.S. offer to Petitioner's shareholders (the "fairness opinion"). Such letter was distributed to Petitioner's shareholders with the Proxy Statement (a copy of which is attached as Exhibit 21-U) for the meeting of Petitioner's shareholders mentioned in paragraph 10 below. A copy of the minutes of the July 10, 1978, meeting of the Board of Directors is attached as Exhibit 22-V.

29. In arriving at its fairness opinion, Morgan Stanley had undertaken a thorough review and analysis of Petitioner's business operations, financial results and future prospects, which it periodically updated as indicated in paragraphs 22, 24, 25 and 27 above. It studied, among other things, Petitioner's consolidated historical and current earnings, cash flow, dividends and book value; it reviewed and analyzed internal financial projections and discussed the business and prospects of Petitioner with its management; and it visited certain of Petitioner's facilities. Morgan Stanley also reviewed and analyzed published information of certain other companies,

compared Petitioner from a financial perspective with those other companies and reviewed and analyzed the terms of comparable acquisitions. It also reviewed the stock market trading price range of Petitioner's common stock for a six-year period and compared such data with statistics for other comparable companies and with market indices. In addition to evaluating Petitioner, Morgan Stanley reviewed and analyzed the business operations, financial results and future operations of Unilever U.S. and its subsidiaries and discussed those matters with their management.

30. On August 15, 1978, a special meeting of Petitioner's shareholders was held at which the merger portion of the transaction was approved by a vote of the shareholders (represented in person or by proxy) of 5,587,672 "for" and 23,065 "against". A copy of the minutes of such meeting is attached as Exhibit 23-W. Pursuant to a letter agreement dated March 16, 1978 (a copy of which is attached as Exhibit 24-X), Mr. Greenwall and his wife voted their shares of Petitioner's common stock for and against adoption of the Merger Agreement in the same ratio as the ratio of the votes cast by the other shareholders of Petitioner. Later the same day, there was a closing of both parts of the transaction pursuant to the Exchange Offer and the Merger Agreement. Morgan Stanley attended the shareholders' meeting and, in connection with the closing, advised Petitioner that there had not been any change in circumstances that would warrant Petitioner's Board of Directors' resolving not to proceed with the transaction.

31. During the course of the closing, the Certificate of Merger was filed with the Delaware Secretary of State along with revisions in Petitioner's Certificate

of Incorporation and the Certificate of Incorporation of Holding. Thereafter Petitioner notified the New York Stock Exchange that its stock was no longer to be listed for public trading.

32. Morgan Stanley charged Petitioner a fee in the amount of $2,200,000 for the services rendered by it to Petitioner and its Board of Directors in connection with the acquisition of Petitioner's stock by Unilever U.S., plus out-of-pocket expenses of $7,586.23 and the legal fee of Morgan Stanley's counsel (Davis Polk & Wardwell) in the amount of $18,000. A copy of a Morgan Stanley invoice to Petitioner dated August 23, 1978, for its services in the matter is attached as Exhibit 25-Y. Such fee of $2,200,000 was based principally on the fee schedule in Morgan Stanley's letter to Petitioner dated December 6, 1977, and was comparable to the amounts that were charged by Morgan Stanley to its clients and by other leading investment banking firms in other corporate acquisitions of a comparable type and magnitude and was reasonable in amount. Lazard charged Unilever U.S. a fee of $2,400,000 for its services in connection with the transaction.

33. DPL&G charged Petitioner a fee of $490,000 for the legal services rendered by it to Petitioner and its Board of Directors in connection with the acquisition of Petitioner's stock by Unilever U.S., plus out-of-pocket expenses of $15,069. Copies of DPL&G invoices (dated March 8, April 6, May 9, September 12 and October 19, 1978) and transmittal letters (dated April 6, May 10 and September 22, 1978) to Petitioner regarding the fees and expenses referred to above are attached as Exhibit 26-Z.

34. In addition to the fees to Morgan Stanley and DPL&G, Petitioner incurred in its 1978 taxable year the following expenses for services rendered to it in connection with the preparation of the Exchange Offer and the Proxy Statement, for the meeting of Petitioner's shareholders held on August 15, 1978, the conduct of such meeting and the consummation of the transaction:

(a) a fee of $27,841 paid to Main Lafrentz & Co. for preparing certain financial statements and information included in the Exchange Offer and the Proxy Statement, as required by the rules and regulations of the Securities and Exchange Commission ("SEC"), and for meeting with Price Waterhouse & Company, accountants for Unilever U.S., to discuss the accounting practices of both companies and to coordinate those practices for application subsequent to the closing of the transaction;

(b) a fee of $69,234 paid to Ad Press, Ltd. for printing the Exchange Offer, the Proxy Statement and related materials distributed to Petitioner's shareholders;

(c) a fee of $1,350 paid to the SEC for filing proxy materials in connection with the transaction, as required by SEC rules and regulations;

(d) a fee of $8,606 paid to Georgeson & Co. for soliciting proxies in connection with the meeting of Petitioner's shareholders. Attached hereto as Exhibit 27-AA is a letter agreement dated April 17, 1978, between Petitioner and Georgeson & Co. together with Georgeson & Co. invoices to Petitioner dated August 23, 1978, August 31, 1978, September 29, 1978, October 10, 1978, and October 30, 1978;

(e) a fee of $22,903 paid to Morgan Guaranty Trust Company of New York for services rendered as transfer agent, depositary and disbursing agent in connection with the transaction and the judge of votes cast at the meeting of Petitioner's shareholders; and

(f) a fee of $22,903 paid to Towers, Perrin, Forster & Crosby ("TPF&C"). Prior to the transaction, Petitioner had issued both qualified and non-qualified options for the purchase of its common stock to approximately fifty of its executives. Some of the options had not been exercised at the time of the transaction while other such options had been exercised. Petitioner had also issued restricted stock to such executives and certain other employees. Under the terms of the Merger Agreement, all such options were to be canceled and all restrictions on issued stock were to be waived prior to the holders' exchanging the stock in the merger. TPF&C was engaged to develop formulas to compensate the executives involved for any financial disadvantage suffered by reason of the merger. Unilever U.S. reimbursed Petitioner for the costs of the payments to the executives. Petitioner paid TPF&C for developing the formulas upon which the payments to the executives were made. Attached as Exhibit 28-AB is a copy of a TPF&C summary of the payout values and a narrative of the payout calculations.

Each of the foregoing fees was determined at arm's-length, was reasonable in amount and was of a type customarily incurred in connection with transactions such as the acquisition of Petitioner's stock by Unilever U.S.

35. The fees and expenses described in paragraphs 32, 33 and 34 above were paid by Petitioner with its own funds, and Petitioner was not reimbursed therefor by Unilever U.S. or any other party.

36. Attached hereto as Exhibit M is a covering letter and a Chronology of Events between October 7, 1977 and December 1, 1977, prepared on behalf of Petitioner and submitted to the SEC in response to an inquiry by the SEC into the pattern of trading activity in Petitioner's stock during this time period. The SEC inquiry was a routine check. Following the receipt of this information the SEC inquiry was concluded without any action being taken or recommended. Petitioner stipulates only that Exhibit M is an authentic copy but does not stipulate as to the truth of the contents thereof and reserves all other evidentiary objections.

37. With respect to those instances referred to in Exhibit M where DPL&G rendered advice to Frank K. Greenwall regarding his personal tax situation it is stipulated that any time charges relating to such personal tax advice were billed to and paid directly by Mr. Greenwall and not by Petitioner.

38. Prior to the discussion of October 7, 1977, Mr. Rohatyn knew Mr. Greenwall as a result of discussions with Mr. Greenwall concerning a prior proposed transaction. Mr. Rohatyn did not, in connection with the transaction in issue, communicate with Mr. Greenwall regarding any interest Mr. Greenwall might have in selling his stock in Petitioner or Unilever U.S.'s interest in acquiring all of Petitioner's stock until after Unilever U.S. had decided to acquire Petitioner and requested Mr. Rohatyn to initiate discussions pur-

suant to which the meeting on October 7, 1977, was arranged.

39. In its Federal income tax return for its 1978 taxable year, Petitioner deducted the Morgan Stanley fee and expenses described in paragraph 32 above, but did not deduct the DPL&G fee and expenses described in paragraph 33 above or the fees described in paragraph 34 above.

/s/ Leonard E. Kust
Leonard E. Kust

WILLIAM F. NELSON
Chief Counsel
Internal Revenue
Service

CADWALADER, WICKERSHAM & TAFT
100 Maiden Lane
New York, New York 10038
(212) 504-6000

By: /s/ Richard J. Sapinski
Richard J. Sapinski
International Special
Trial Attorney

June 4, 1987

600 Arch St., Rm. 10424
Philadelphia, Pa. 19106

[Exhibit 2-B]

Internal Revenue Service

Department of the Treasury
A:Nwk:NBB:GT:90D

Date: JUN 12 1984

CERTIFIED MAIL

Social Security or
Employer Identification Number:
13-1522451
Tax Year Ended and Deficiency:

August 15, 1978 - $1,068,281.00

▷ National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Person to Contact:

Noel B. Butler
Contact Telephone Number:

201-645-2212

— Dear Sir or Madam:

We have determined that there is a deficiency (increase) in your income tax as shown above. This letter is a NOTICE OF DEFICIENCY sent to you as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this deficiency in court before making any payment, you have 90 days from the above mailing date of this letter (150 days if addressed to you outside of the United States) to file a petition with the United States Tax Court for a redetermination of the deficiency. The petition should be filed with the United States Tax Court, 400 Second Street NW., Washington, D.C. 20217, and the copy of this letter should be attached to the petition. The time in which you must file a petition with the Court (90 or 150 days as the case may be) is fixed by law and the Court cannot consider your case if your petition is filed late. If this letter is addressed to both a husband and wife, and both want to petition the Tax Court, both must sign the petition or each must file a separate, signed petition. You can get a copy of the rules for filing a petition by writing to the Clerk of the United States Tax Court, at the address shown in this paragraph.

If you decide not to file a petition with the Tax Court, we would appreciate it if you would sign and return the enclosed waiver form. This will permit us to assess the deficiency quickly and will limit the accumulation of interest. The enclosed envelope is for your convenience. If you decide not to sign and return the waiver and you do not timely petition the Tax Court, we will assess and bill you for the deficiency after 90 days from the above mailing date of this letter (150 days if this letter is addressed to you outside the United States).

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely yours,

Roscoe L. Egger, Jr.
Commissioner
By
(SIGNED) JOSEPH LEVINE

Associate Chief,
Appeals Office

Enclosures:
Copy of this letter
Statement
Waiver
Envelope

Newark Appeals Office
970 Broad St., Room 702, Newark, NJ 07102

Letter 894(RO) (Rev. 4-82)

Form **4089**
(Rev. January 1983)

Department of the Treasury – Internal Revenue Service

Notice of Deficiency-Waiver

Symbols

A:Nwk:NBB:GT:90D

Name, SSN or EIN, and Address of Taxpayer(s)

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Kind of Tax

Income

[X] Copy to Authorized Representative

Mr. Leonard E. Kust and Mr. Geoffrey R.S. Brown
c/o Cadwalader, Wickersham & Taft
One Wall Street, New York, New York 10005

Tax Year Ended	Deficiency	
	Increase in Tax	Penalties
August 15, 1978	$1,068,281.00	

See the attached explanation for the above deficiencies

I consent to the immediate assessment and collection of the deficiencies (increase in tax and penalties) shown above, plus any interest provided by law.

Your Signature ▶ ..... (Date signed) .....

Spouse's Signature, If A Joint Return Was Filed ▶ ..... (Date signed) .....

Taxpayer's Representative Sign Here ▶ ..... (Date signed) .....

Corporate Name: .....

Corporate Officers Sign Here ▶ ..... (Signature) (Title) (Date signed)

▶ ..... (Signature) (Title) (Date signed)

Note:

If you consent to the assessment of the amounts shown in this waiver, please sign and return it in order to limit the accumulation of interest and expedite our bill to you. Your consent will not prevent you from filing a claim for refund (after you have paid the tax) if you later believe you are entitled to a refund. It will not prevent us from later determining, if necessary, that you owe additional tax; nor will it extend the time provided by law for either action.

If you later file a claim and the Internal Revenue Service disallows it, you may file suit for refund in a district court or in the United States Claims Court, but you may not file a petition with the United States Tax Court.

Who Must Sign

If this waiver is for any year(s) for which you filed a joint return, both you and your spouse must sign the original and duplicate of this form. Sign your name exactly as it appears on the return. If you are acting under power of attorney for your spouse, you may sign as agent for him or her.

For an agent or attorney acting under a power of attorney, a power of attorney must be sent with this form if not previously filed.

For a person acting in a fiduciary capacity (executor, administrator, trustee), file Form 56, Notice Concerning Fiduciary Relationship, with this form if not previously filed.

For a corporation, enter the name of the corporation followed by the signature and title of the officer(s) authorized to sign.

If you agree, please sign one copy and return it; keep the other copy for your records.

BEST AVAILABLE COPY

Form 5278 (Rev. May 1982)	Department of the Treasury – Internal Revenue Service **Statement — Income Tax Changes**	Return Form 1120	Schedule No. 1

Name(s) of Taxpayer(s)

NATIONAL STARCH AND CHEMICAL CORPORATION

☒ Notice of Deficiency ☐ Other *(specify)*
☐ Settlement Computation

	Tax Years Ended		
	August 15, 1978		
1. Adjustments to income			
a. See Schedule 4549-B Attached	$ 1,779,241		
b.			
c.			
d.			
e.			
f.			
g.			
2. Total adjustments	1,779,241		
3. a. ☒ Taxable income ☐ Adjusted gross income b. As shown in: ☐ Tax table income ☐ Preliminary letter dated _____ ☐ Notice of deficiency dated _____ ☒ Return as filed	15,544,764		
4. ☒ Taxable income as revised ☐ Tax table income as revised ☐ Adjusted gross income as revised	17,324,005		
5. Tax from ☐ Tax tables ☐ Tax rate schedules ☐ Schedule TC			
6. Alternative tax if applicable *(from page 5)*	8,299,525		
7. Corrected tax liability *(lesser of line 5 or 6)*	8,299,525		
8. Less credits *(specify)* a. Foreign Tax Credit	723,808		
b. Investment Credit	448,557		
c.			
9. Balance *(line 7 less amounts on lines 8a through 8c)*			
10. Plus a. Tax from recomputing prior year investment credit	7,127,160		
b. Self-employment tax	582		
c.			
11. Total corrected income tax liability *(line 9 plus amounts on lines 10a through 10c)*	7,127,742		
12. Total tax shown on return or as previously adjusted Assessment 4-20-84	257,444 5,802,017		
13. Increase or (decrease) in tax *(difference between lines 11 and 12)*	$ 1,068,281		

14. Additions to the tax *(listed below)*

• U.S. GOVERNMENT PRINTING OFFICE: 1983 - 381-541/5235

Form 4549-B (Rev July 1980)

Department of the Treasury - Internal Revenue Service

Income Tax Examination Changes

Name and Address of Taxpayer

NATIONAL STARCH AND CHEMICAL CORPORATION

Social Security or Employer Identification Number

13-1522451

Adjustments to Income	Year 7808	Year:	Year:
(a) Professional Advisory Fees	$ 2,225,586		
(b) Depreciation	(474,609)		
(c) Depreciation	(2,750)		
(d) Amortization	(781)		
(e) Schedule D - LTCG	909		
(f) Interest Income	222		
(g) Bad Debts	40,000		
(h) Taxes State Income	596,276		
(i) Commission Expense	62,928		
(j) Interest Expense	(30,784)		
(k) Deemed Distribution	(147,172)		
(l) Taxe Expense	(4,508)		
(m) Dividend Income - Section 78 Gross-Up	(467,245)		
(n) Salaries and Wages	(18,831)		
Total Adjustments This Page	$ 1,779,241		

FORM 886-A (REV APRIL 1968)	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT 1(a)
NAME OF TAXPAYER NATIONAL STARCH AND CHEMICAL CORPORATION		YEAR/PERIOD ENDED August 15, 1978

(a) It is determined that the payment of $2,225,586.00 to Morgan Stanley and Company, Incorporated and taken on your return as a deduction for professional advisory fees represents a capital expenditure and, therefore, not deductible as an ordinary and necessary business expense. Accordingly, your taxable income is increased $2,225,586.00 for year ended August 15, 1978.

(b) Thru (n) and foreign tax credit - Adjustments in accordance with explanations and schedules previously furnished to which you have agreed.

SCHEDULE D
(Form 1120)

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to your income tax return.

1978

Name

NATIONAL STARCH AND CHEMICAL CORPORATION

Employer Identification Number
13-1522451

Part I Short-term Capital Gains and Losses—Assets Held ONE YEAR or Less

a. Kind of property and description (Example, 100 shares of "Z" Co.)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price less expense of sale	e. Cost or other basis	f. Gain or (loss) for the year (d less e)	g. Gain or loss after 12/31/78 see instructions
1						
2 Unused capital loss carryover (attach computation)						
3 Net short-term capital gain or (loss)						

Part II Long-term Capital Gains and Losses—Assets Held More Than ONE YEAR

4 Enter section 1231 gain from Form 4797, line 6(a)(1)						
5						
6 Net long-term capital gain or (loss)						

Part III Summary of Schedule D Gains and Losses

7 Enter excess of net short-term capital gain (line 3) over net long-term capital loss (line 6)		
8 Enter excess of net long-term capital gain (line 6) over net short-term capital loss (line 3)	13,873	
9 Total of lines 7 and 8. Enter here and on Form 1120, line 9(a), page 1	13,873	

Part IV Alternative Tax Computation

(Fiscal year corporations, do not complete Schedule D (Form 1120), Part IV but instead complete Form 1120-FY (1978-79))

10 Taxable income (Form 1120, line 30, page 1)	17,324,005	
11 Excess of net long-term capital gain over net short-term capital loss	13,873	
12 Subtract line 11 from line 10	17,310,132	
13 Enter line 12 or $25,000, whichever is less. (Members of a controlled group enter one-half of surtax allocation, see instructions)	25,000	
14 Subtract line 13 from line 12	17,285,132	
15 Enter line 14 or $25,000, whichever is less. (Members of a controlled group enter one-half of surtax allocation, see instructions)	25,000	
16 Subtract line 15 from line 14	17,260,132	
17 20% of line 13	5,000	
18 22% of line 15	5,500	
19 48% of line 16	8,284,863	
20 30% of line 11	4,162	
21 Alternative tax—total of lines 17 through 20. If applicable, enter here and on Form 1120, line 9, Schedule J, and write "ALT." in the margin to the right of the entry	8,299,525	

[Exhibit 3-C]

Dear Friends:

Sales and earnings reached record levels in 1978 for the 26th consecutive year, except for earnings in 1969. Sales were up 13.0 percent over 1977 and earnings were up 14.4 percent. In many areas, earnings were adversely affected by lower operating margins resulting from the pressures of inflationary increases in raw material and other costs against competitive selling prices. Earnings were favorably affected, however, by substantial improvement in the sales and margins of joint ventures and by balance sheet translation gains.

Research and development and related technical activities continued to increase in 1978 throughout all phases of our operations. Our research and development activities incurred expenses for the year 1978 that amounted to $7.4 million.

Our research and development efforts in 1978 have continued as productive as ever judging by the number of patents filed, new and improved products developed, new markets found, new processes developed and the steady advance of earlier development projects to commercial status. Many of these accomplishments will be mentioned in the latter pages of this report, but we do want to emphasize that it is this continuing flow that gives us confidence in our future growth.

Also important in our pattern of growth, our work on acquisitions has continued through the year. Our goal in acquisitions and joint ventures is to seek footholds in new but related areas, or to expand more rapidly in areas where we are established or have

made a commitment and a start. For example, during the year we acquired a small operation in Detroit, Mich., which strengthens the position of our Bondmaster Department in the automotive field by giving us established contacts and new approved product sealants and adhesives for this market.

Other examples are the acquisition of Leland Chemical Company at Leland, N.C., and the technology and business of Haven Chemical Company, Philadelphia, Penn. Leland gives us additional capacity and new technology for high pressure reactions, as well as some established sales of cosmetic and pharmaceutical intermediates. Haven provides us with an additional line of specialty monomers for sales to the plastics, rubber and fiber industries. While they are small operations, they represent a natural addition to and extension of Proctor Chemical Company operations.

In another area, we have acquired Dycol Chemical Company, a small company processing and marketing guar gum. National has long had an interest in entering the natural gum market, and the acquisition of Dycol represents our first venture. Guar gum, because of its special properties, is marketed as a water retention aid in oil well muds, textile printing and for other uses and applications with which National is familiar. We are in a position to apply and use our specialty polymers derivatization technology to develop new guar products for these markets as well as for other markets where it is anticipated that guar products can be used.

In still another area, early in 1979 we purchased certain operations of Bear Hybrid Seed Company relating to the breeding and production of specialty

corn hybrid seeds. Bear has been the sole producer of high amylose hybrid corn seed which is the basis for an important segment of National's starch sales to the corrugating industry and of certain starches sold to the food industry. In addition, Bear has been a producer of waxy hybrid seed, the basis for the waxy corn which is a major raw material for our starch operations. This acquisition will be combined with our Customaize operation in order to produce better agronomic strains of specialty hybrid seeds, as well as to develop strains with higher levels of starch and possibly different types of starch.

Capital expenditures in 1978 reached a new all-time high of over $35 million, up substantially from $15.7 million in 1977 and an annual average of $18.3 million in the 1974-1976 period. This increased level of investment reflects the growth of our volume in specialty starches, hot-melt adhesives, resin emulsions and in specialty chemicals at Proctor Chemical Company. It will also relieve some inefficiencies suffered during 1978 as a result of operating at higher than optimum production levels.

While 1978 expenditures were spread over many projects, by far the largest multi-million dollar expenditure was for Phase I of the expansion of our corn grinding and specialty starch capacity at Indianapolis, Ind., which is essentially completed. Other important projects were a new, more efficient Permabond plant to produce cyanoacrylate adhesives in Bridgewater, N.J., a semi-works plant in Salisbury, N.C. for the production of PERMASORB®, our high water absorbing polymer, an expanded resin facility at Meredosia, Ill., to be completed in early 1979 and a number of

facilities and equipment installations for specialty chemicals at Proctor.

We anticipate one more year of unusually high capital expenditures in 1979 in order to complete the round of capacity expansions currently under way. Major items will be the completion of Phase I at Indianapolis and the initiation of Phase II, still more resin emulsion and hot-melt adhesives capacity, and expansion of our Process Development facility at Plainfield, N.J.

Investments required to meet environmental regulations represent between 5 percent and 7 percent of our total capital investment, and will undoubtedly increase as will the cost of their operation. We are concerned with these ever stricter requirements and question in many cases that the levels of risk justify the extremely high standards being set by regulatory agencies. Nevertheless, we have done our best to meet all such standards and anticipate no serious problems in continuing to do so.

On this subject, it is worthy of mention that our research and development have provided specialty industrial products, starches, resins and adhesives which make a contribution to our customers' operations by reducing air and water pollution and at the same time improving yields, efficiency and safety.

It is a firm part of our philosophy to practice equality of opportunity in our employment practices and to provide for the health and safety of our employees and the people who use our products. We should mention that 1978 again proved to be a year of considerable progress in plant safety with two-thirds

of our domestic locations showing gains in measured performance.

Plants throughout the company have introduced new energy conservation measures as part of an ongoing program. Every six months we calculate the energy used to produce a pound of product for the preceding twelve-month period. Steam generating systems are now more efficient and our dust and fume removal systems now use less energy.

In August 1978, upon the completion of the Unilever merger, a number of previously planned management changes were effected. Frank K. Greenwall, formerly Chairman of the Executive Committee, became Chairman of the Finance Committee, and Donald D. Pascal, formerly Chairman of the Board, became Chairman of the Executive Committee. In succession and together, Messrs. Greenwall and Pascal have directed our company's affairs for a great many years and have provided the leadership for the record growth we have enjoyed. Their continued participation provides an important contribution to our management.

Carlyle G. Caldwell, formerly President, became Chairman of the Board, continuing as Chief Executive Officer, and Wallace K. Grubman, previously Group Vice President, became President and Chief Operating Officer.

As anticipated, the merger with Unilever has not affected our organization or our real work of providing ever more and better service to our customers. We will benefit greatly from the availability of Unilever's enormous resources, especially in the area of basic technology.

We are most pleased that our four outside directors continue their full interest in National even though we are no longer a public company.

To all employees, it bears repeating that National is people. National's style, its character, its relationship with customers and suppliers, and with our associated companies, remains unchanged. Our will and ability to achieve our goals are derived from dedicated people who take great pride in our company's continued progress and achievement.

Even though we seem to live and work in an ever more complex world, we have every confidence that we will successfully meet the challenges of 1979 and the years ahead.

Many thanks to all who have contributed to our growth.

Carlyle G. Caldwell
Chairman of the Board and
Chief Executive Officer

Wallace K. Grubman
President and
Chief Operating Officer

1978

What the Future Holds

It is certainly easier to write about the future in the light of another successful year in 1978. Not that the future is easy to see, but certainly in a world in which technology is so dynamic, the future is bound to hold many opportunities, as well as some surprises.

Short run, of course, we find ourselves enjoying a relatively good economic climate and while some near future hesitation may occur, hopefully, it will be short-lived and not too disabling. Even in good circumstances, however, we find our progress unnecessarily hampered by two outstanding road blocks—inflation and over-regulation by governments. Anything we can do as private citizens to bring about reduced government spending and smaller budget deficits will do much to enhance the results of our business and our personal efforts.

What does the past tell us about the future? What have been the strengths which have made us grow over the last 25 years by 15 times in sales and by more than 20 times in before-tax profits and net worth?

Our number one asset by far is our people, who are well-trained, experienced and acknowledged as leaders in their respective fields.

National's innovations over the years attest to these qualities and to their diligence and ability to work hard as a well-coordinated team. We have plowed back our earnings into fully equipped and sophisticated plants and laboratories. We have located ourselves in growing markets around the world

and have created products with a great diversity of growing end uses.

Technology, both in the laboratory and in our customers' plants, has spearheaded our ability to serve these markets with innovative products and new concepts. We have a great reservoir of knowledge and experience with which to continue to find new ways to solve the problems which beset our customers, in a never-ending stream of opportunities for National.

This past year we became associated with Unilever, a major worldwide company with principal interests in the food and detergent areas. Their policy permits us to continue the business philosophies and practices which have promoted our past growth and, at the same time, provides new opportunities and resources.

So, putting it all together, everything points to a company with both the tools and the markets to continue and, hopefully, to expand a long-standing pattern of growth. There will be obstacles, of course. Some technological developments, as always, will be unfavorable and, as mentioned, government regulations and overspending remain problems. While we cannot discount such developments, we can make sure that they have only a minimal effect on the course of our progress.

The opportunities to help direct National's operations and the consequent rewards and promotions will go, of course, to those who successfully keep us on track.

Donald D. Pascal
Chairman of the
Executive Committee

[Exhibit 12-L]

MORGAN STANLEY & CO.
Incorporated
1251 Avenue of the Americas
New York, N.Y. 10020

December 6, 1977

Mr. Donald D. Pascal
Chairman of the Board
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Mr. Pascal:

In connection with our proposed assignment from National Starch and Chemical Corporation I am writing to provide a detailed description of our approach to matters of this nature. I have also provided a brief review of the Merger and Acquisition Department of Morgan Stanley and a summary of Morgan Stanley's fee schedule for assignments of this size and scope. We understand that National Starch is interested in having Morgan Stanley review its strategic alternatives within the context both of the longer term situation of a 15% equity ownership in National Starch which at some point will be transferred from its present individual "founding" owners and of an evaluation of an immediate proposed business combination involving Unilever.

The special requirements for planning and executing merger and acquisition assignments were recognized by Morgan Stanley many years ago. These requirements, coupled with increased demand for acquisition services by our clients, evolved in 1971 into

a major commitment on the Firm's part to these activities. Morgan Stanley now has a separate, full-time Merger and Acquisition Department within the Firm, headed by two Managing Directors and supported by four Vice Presidents, eight associates and eight Research Analysts. In addition, officers and staff from other areas of the Firm augment the assignments managed by the Department when special skills or manning are required. Major valuation judgments or strategic matters are considered by a larger group of officers from various functional areas of the Firm so that advice rendered to a client represents a consensus judgment of a broad and experienced group.

While a major portion of our assignments have involved representation of acquirors, we have considerable experience in representing acquirees. For example, we represented Otis during its acquisition by United Technologies as well as finding buyers for La-Terre Co., Inc., Pan Ocean Oil Corporation and Burmah Oil Incorporated which were sold to Tenneco, Marathon Oil and R. J. Reynolds, respectively. Currently, among projects which are of public record, we are advising Franklin Life in connection with its acquisition by American Brands, we are assisting Babcock & Wilcox Company relating to its acquisition by J. Ray McDermott & Co., Inc. as well as Carborundum Company in the proposed acquisition by Kennecott Copper Corporation.

At the present time we envision that our assignment from National Starch would involve several phases:

Preliminary Analysis. Initially, we would conduct a detailed investigation and analysis of National Starch and Chemical Corporation with a view toward understanding its business and its stockholders. In connection with reviewing National Starch's situation, we understand that approximately 15% of the common stock is beneficially owned by Mr. and Mrs. Greenwall, aged 81 and 79, respectively.

Review of Alternatives. The results of this analysis coupled with our active involvement with a number of major industrial companies and our understanding of their acquisition criteria would allow us to judge the realistic alternatives available to National Starch both as to price and structure of a transaction with another company. Within the framework of the alternatives available we would then be in a position to evaluate the structure and value of a possible combination with Unilever.

Valuation. A crucial part of our role in this type of assignment is our valuation of the client company. A valuation judgment is based upon, in part, an extensive study of the financial and operating record of National Starch (including a comparison of the company's performance relative to other companies with similar lines of business), the relative market performance of the company's securities, a study of the capitalization of the company, an investigation of the terms of acquisitions of companies of a comparable

nature, an appraisal of the company's future prospects and other relevant factors. A memorandum containing these studies is circulated to a number of senior members of the Firm as well as to others within the Firm who may have particular experience bearing upon the businesses involved. This group then meets to develop a consensus opinion and to formulate Morgan Stanley's recommendations.

Upon the completion of the preliminary analysis and review of the alternatives and valuation, we would plan to deliver an oral report to National Starch setting forth our views as to the alternatives available, our recommendations regarding these alternatives taking into account the interests of the company's stockholders and employees and our analysis of the Unilever proposal.

Negotiating and Structuring Transactions. During the analytical phase of an assignment, we develop a judgment as to values and a thorough understanding of the legal and financial implications of various forms of transactions. Such knowledge, combined with the perspective of a third party, is invaluable in negotiations, particularly if important decisions must be made rapidly and under pressure, as is often the case in business combination negotiations.

Many companies are familiar with Morgan Stanley and, we believe, have respect for the quality of our work and fairness of our positions. We feel that this reputation will lend additional credibility to National Starch's bargaining position. Thus, if it develops that

National Starch and a prospective partner have differing initial assessments as to value, such credibility can be helpful in bridging early disagreements and preventing a premature termination of discussions before negotiations have reached a critical stage. It is also our experience that an intermediary is often of considerable assistance in maintaining momentum throughout ensuing negotiations.

Rendering an Opinion. Often we are asked to express a written opinion regarding the fairness of the financial terms of a transaction. Such an opinion might be for the benefit of either a client's management or its board of directors. The opinion of an independent financial expert, advising that a transaction is "fair and equitable" to shareholders, can be of significant comfort to directors of a public corporation seeking to act in the best interests of those shareholders. If requested in connection with this assignment we would expect to provide a written opinion regarding the fairness of the financial terms of the transaction and to have this opinion included in a prospectus or proxy statement, which, depending on the ultimate form of the transaction, will be required.

Coordinating Technical Details. Following an agreement in principle, we would assist you in organizing and coordinating your other experts and advisors and would attend to the numerous technical details required in closing a transaction. The subsequent steps may include: drafting a merger agreement or tender or exchange offer documents; designing employment and bonus agreements; preparation of proxy materials; and requesting a tax ruling if neces-

sary. These tasks are often the most time-consuming aspects of a transaction, requiring an anticipation of problems and experienced coordination of attorneys, accountants, and other experts as appropriate, at the same time making sure the understanding between the principals is not unnecessarily affected.

Our fees for services of this nature ordinarily involve two components, depending upon whether or not a combination is successfully consummated. In the event that no acquisition is consummated, we normally charge a fee which reimburses us only for our effort expended on the assignment. This fee would normally be in the area of $75,000 to $100,000. Should an acquisition be successfully concluded, however, we believe a more substantial fee is appropriate. This fee, which would include the aforementioned fee, is based upon a number of considerations including the market value of the transaction and our contribution to its successful completion. Set forth below is our standard fee schedule for completed transactions.

Approximate Market Value of Transaction	Approximate MS&Co. Fee as a % of Value of Transaction
$ 200 million	3/4%
300 million	5/8%
400 million or greater	1/2%

Should a transaction not be completed that has progressed to the stage where proxy and registration material have been filed and a Firm opinion as to

fairness rendered, a fee in the area of $500,000 would be appropriate. Should a transaction where an agreement in principle has been reached not be consummated, a fee in the area of $250,000 would be appropriate. In all cases any interim fees would be credited against our fee for a completed transaction should one be effected.

The fee levels that we have indicated above are based upon what we believe will be a valuable and significant contribution by Morgan Stanley to meeting the business and financial objectives of National Starch and Chemical Corporation. These fees are consistent with our overall compensation practices and with actual fees charged to other clients for similar services.

It should be noted that it is the practice of our Firm that, in all cases, in addition to a fee for our professional services, we be reimbursed for out-of-pocket expenses and our attorneys' fees, should their advice be required. It is also our policy to seek indemnification against liabilities which might arise in connection with the work we undertake on behalf of a client.

I hope this letter is responsive to your request. We are confident that our Firm has the skill and expertise with which to supplement your own resources to achieve a satisfactory outcome that is in the best interests of National Starch and Chemical Corpora-

MORGAN STANLEY & CO.
Incorporated

tion and its shareholders. We look forward to working with you.

Very truly yours,

/s/ Robert F. Greenhill

Robert F. Greenhill
Managing Director

[Exhibit 13-M]

Morgan Stanley & Co. Incorporated
1251 Avenue of the Americas
New York, New York 10020

Gentlemen:

This letter will confirm that we have engaged Morgan Stanley & Co. Incorporated to advise and assist us in connection with the possible sale or disposition of National Starch and Chemical Corporation, in accordance with your letter to us dated the date hereof. Since you will be acting on our behalf, we agree to indemnify and hold you (including affiliated companies and any of your affiliates, officers, directors, employees or controlling persons) harmless from and against all claims, liabilities, losses, damages and expenses as they are incurred (including reasonable fees of your counsel) related to or arising out of any actual or contemplated sale or disposition by us of National Starch and Chemical Corporation or your role in connection therewith. We shall not, however, be responsible for any claims, liabilities, losses, damages or expenses to the extent they result primarily from actions taken, or omitted to be taken, by you in bad faith or from your negligence.

It is understood that you will keep confidential and will not use in any improper way the information and data about us or our subsidiaries obtained by you in connection with your engagement.

It is understood that your services hereunder may be terminated with or without cause by you or by us at any time and without liability or continuing obligation to you or to us (except for any compensation earned by you up to the date of termination and except for the

provisions relating to confidential information) and provided that the indemnity provisions relating to or arising out of any matter in connection with which you shall have advised or assisted us prior to such termination, will remain operative regardless of any such termination.

We further understand that if you are asked to furnish us with a financial opinion letter or act for us in any other formal capacity, such further action may be subject to a separate agreement containing provisions and terms to be mutually agreed upon.

Very truly yours,

NATIONAL STARCH AND
CHEMICAL CORPORATION

By /s/ Donald D. Pascal

Accepted:

MORGAN STANLEY & CO.
INCORPORATED

By /s/ Robert F. Greenhill
Managing Director

Date: 12/6/77

[Exhibit 14-N]

PROJECT BUTTONDOWN

Assignment:

Advice as to fairness to the shareholders of Buttondown Corporation ("Buttondown" or the "Company") of a possible business combination with the Unilever Group.

Questions:

1) Does a cash price in the area of $65-$70 per share represent fair value to the shareholders of Buttondown?

2) Is it realistic to expect that more attractive alternatives exist for the shareholders of Buttondown in the context of an affiliation with another company.

3) If an agreement should be reached as to price, is the structure presently proposed, which could involve the receipt by certain shareholders of shares of a low dividend preferred stock of a new U.S. holding company, acceptable from a credit and liquidity standpoint?

Background

The Unilever Group (Unilever N.V. and Unilever Ltd., U.S. subsidiary—Unilever U.S.) ("Unilever") recently approached the principals of Buttondown Corporation, a manufacturer of specialty starches, adhesives and chemicals, through Lazard, Freres & Co., indicating a strong interest in purchasing all the outstanding shares of Buttondown shares

for cash. MS&Co. was retained by Buttondown on Tuesday, November 15. The principals, particularly Frank K. Greenwall, Chairman of the Executive Committee and holder of the one million of the Company's shares (approximately 6.6 million shares outstanding), expressed an interest in a thorough evaluation as to the prospective offer by Unilever as well as receiving any advice the Firm might have as to the possibility of developing alternative options which might be available to the Company.

Mr. Greenwall's shares, together with what may be as many as 500,000 additional shares, are held at a rather low tax basis. The magnitude of potential capital gain tax liabilities which could accrue to the holders has given rise to the creation, with the consent of both sides, of a possible transaction structure which would involve an exchange offer of a low dividend non-voting straight preferred. Those shareholders not electing to take the preferred would receive cash through a merger between Buttondown and a shell subsidiary of Unilever. From a tax standpoint the transaction has been structured to qualify under Section 351. While this form of transaction has never before been accomplished, lawyers from both sides have talked to the IRS on a no names basis and at this point the IRS has stated that it "can find no reason not to approve the transaction". The structure involves the creation of a new Unilever (U.S.) holding company to issue the preferred and which would hold all of the shares of the Company following a cash merger. This holding company would also hold funds for the purpose of redemption (at the option of the holders after five years) of the preferred stock. Since in only a few cases is the exact basis of the low basis shareholders actually known, it is difficult to judge the amount of preferred

stock which might be elected. However, the best estimate developed has been in the area of $70-$100 million.

Conclusion:

1) It appears that a price between $65 and $70 per share would represent fair value for the shareholders of Buttondown.

2) If the proposed tax-free structure is utilized either a) some method must be developed to *specifically segregate* assets for redemption of the outstanding preferred stock, b) restrictive covenants must be created for both the holding company and Buttondown to safeguard the credit position of the preferred holders, or c) the Unilever parent credit must be made available.

3) For planning it appears unlikely that another company, especially a U.S. company in the context of a tax-free transaction, would be prepared to pay the same price as that being proposed by Unilever.

BUTTONDOWN CORPORATION
Summary Description

History

The Buttondown Chemical Corporation ("Buttondown" or "the Company") began in 1895 as the National Gum & Mica Co., a producer of starch jelly gums and glue sizings. The National Adhesives Corporation was formed in 1928 to consolidate National Gum & Mica operations with those of two smaller adhesives companies. Operations (sales reached $1 million in 1926) focused on the production of industrial adhesives for the paper converting (boxes, bags, envelopes), leather goods and packaging (labeling and sealing) industries. In 1939, the Company purchased the Piel Brothers starch plant in Indianapolis in order to produce its own corn starch and to move into new markets. Prior to World War II the Company began to develop specialty starches through newly designed conversion processes for use in wet-end additions in the paper industry as well as for yarn sizing and printing and finishing in the textile industry.

Shortages of tapioca (a prime starch source) during World War II led to the Company's development of special varieties of "waxy" corn, the conversion of which resulted in starches with superior thaw/freeze, drying and hardening qualities. With these specialty starches, Buttondown moved into the food starch business. This period also saw the development of synthetic polyvinyl acetate adhesives. These moisture-resistant, fast-setting resin formulations had properties favorable to high-speed packaging processing as well as to structural adhesive and coating applications.

Post World War II expansion included construction of a vinyl polymerization plant as well as several subsequent additions at Meredosia, Illinois, central adhesive plants at Plainfield, N.J., Chicago and San Francisco and a vinyl acetate monomer facility at Long Mott, Texas. As a result of a number of small acquisitions (see Exhibit XX), participation in joint venture as well as internal growth, the Company has reached the $350 million sales level and currently employs 3,730 people at a total of over 60 facilities in the U.S. and a number of foreign countries (see Exhibits I, XIII and XXVI).

Products and Markets

Buttondown currently produces a broad range of specialty starches, adhesives and related chemical products deriving from both organic and synthetic bases (see Exhibits XV and XVI).

Adhesive and Related Products

The Company offers an extensive line of adhesives and related products based upon synthetic raw materials, primarily vinyl acetate polymers and copolymers but also including acrylics, neoprenes, polyesters, polyamides, expoxies and other bases. Starch, principally from corn, is also used as a base. Major uses for the company's adhesives are general packaging (surface labeling of bottles, cans and paper and plastic containers, case and carton sealing and package wrapping) and paper converting (manufacture of envelopes, paper and plastic bags, boxes, cups and composition cans and tubes). Most of these adhesives are used on automatic packaging or fabricating equipment or in other specialized operations. As an example, the Company's multi-viscosity adhesives

are used on high speed envelope machines for back seams and window patches. Related to the paper converting area is a full line of specialty adhesives for laminating various transparent films and foils used primarily in the meat and dairy industries.

The Company produces adhesives used in manufacturing pressure-sensitive tapes, labels, decals and re-moistenable wallcoverings; fabricating furniture and cabinets (quick-curing "white glues" for finger joints, edge gluing and surface laminating); bonding insulation and structural panels to interiors and exteriors of buildings and vehicles; and applying insulation to industrial heating and air conditioning equipment. Other products manufactured include a complete line of sealants, flexible package layer adhesives (e.g. boilable pouches), "not melt" adhesives for book-binding, pre-mixed high technology adhesives and potting compounds, primarily for the electronics industry, and lines of cyanoacrylate, anaerobic and "cure-on-demand" adhesives for parts assembly and other industrial purposes. In Canada, England, and Australia, the company makes a broad line of adhesives and related materials sold to consumers in small packages (the Le Page subsidiary has 80% of the packaged glue market in Canada). Retail size packages of cyanoacrylate and certain other adhesives are also made and sold in the United States.

Starches and Related Products

The Company extracts starch from standard and specialty corns by the wet-milling process (which involves grinding the corn kernel while wet and the separation of its starch and other components). Unlike most corn wet-millers, the Company does not make sweetners (volume, commodity-type products)

nor does it package corn starch for retail use. Typically, the Company modifies such starches, as well as imported tapioca starch, to make specialty products designed for a wide variety of end uses. By-products, which are recovered in the corn wet-milling process and sold, include unrefined corn oil and glutent feed and meal. The largest users of the Company's starch products include the food industry (40 starches and derivatives used as stabilizers, texturizers, fillers, thickeners and extenders in products such as canned and frozen foods, pie fillings, puddings and baby foods) and the paper industry (principally as binders and size and production aids in the paper-making process). The Company pioneered the introduction of cationic starches in the paper industry which provide such performance prosperities as strength additives and production aids which are not available with conventional [illegible]rches. Specialty starch products are also used in corrugating board, packaging, paper converting and other adhesive applications. Other markets include the textile, pharmaceutical and pet food industries. Through subsidiaries, the Company also makes and sells a line of food intermediates, seasonings and flavors sold to the baking, snack, and food processing industries and also grows and sells to farmers regular hybrid corn seed and some varieties of waxy corn seed.

Chemical Products

The Company manufactures a wide variety of vinyl acetate and other types of polymers and copolymers, both for use by the Company in its production of formulated adhesives and for sale to such markets as the paper, cosmetic, textile and building products industries. The Company is a major supplier of special-

ty polymer affixants for hair sprays, eye liner and liquid shampoo, of cationic polyelectrolytes to the paper industry as production aids and for effluent treatment, of binders for non-woven fabrics and other products for specialized end uses. An example of a major Buttondown product use in the papermaking process is Natron, a synthetic polyelectrolyte flocculant, which acts to deposit fine solids and debris on the longer wood fibers prior to paper sheet formation thus allowing a more open fiber web, better pigment retention, better effluent clarification and faster draining and drying. In the non-woven area the uses include the binding of the seams of layered disposable diapers, tampons and napkins where the non-woven web may be rayon, polyester or wood fiber-based. Through subsidiaries, the Company produces textile finishing chemicals (the Proctor Chemical subsidiary produces resins used in permanent press materials), specialty chemicals for yarn and carpet manufacturers, and a variety of proprietary organic chemicals and polymers to include resins used in manufacturing glass fibers, the primary reinforcing material in fiberglass reinforced plastics, and custom-manufactured chemicals for other companies. In Canada, the Company makes and sells, in small packages, formulated products for coating, repair and up-keep of concrete and masonry floors and walls, a line of wood stains and coatings, and a line of patching compounds and paint strippers and cleaners.

Raw Materials

The Company's principal raw materials are corn (including standard, waxy, and high amylose corn), acetylene and acetic acid. Additionally, Buttondown Corporation routinely uses a variety of acids, alkalis,

alcohols, polymers, copolymers and resins in its manufacturing operations. The Company depends on one source for a predominance of its acetylene; however, the Company feels that it has no reason to expect any curtailment in that supply.

The Company hedges portions of its specialty corn purchases through the use of the corn futures market although due to the nature of its operations a substantial portion of its requirements are purchased in the spot market.

Competition

Primary competitors in the Company's lines of business are as follows:

Starches (food area):

1. A.E. Staley Manufacturing
2. American Maize Products
3. CPC International
4. Cargill
5. Archer-Daniels-Midland

The Company suggests that none of these firms are major factors in the specialty sector of this business.

Starches (industrial, primarily paper):

A.E. Staley Manufacturing

The Company feels that it commands a very strong market position in this area.

Synthetic Resins:

1. Rohm & Haas
2. Union Carbide
3. Goodrich

4. Dow Chemical
5. Air Products Corporation
6. National Distillers

Adhesives:

1. H.B. Fuller
2. Borden Corporation
3. Celanese, Stein-Hall division

The Company believes that is is the largest producer in this particular market.

Anaerobic Adhesives:

1. Loctite Corporation

Loctite is the major producer in this market.

Customer Base

The Company sells to a large number of industrial users (see Exhibit XIX) through a large selling staff (250) as well as through jobbers, brokers and other distributors. Sales representatives maintain maximum contact with customers at their plant locations and most have developed substantial expertise in the users' industries. These representatives work in close conjunction with the 350 technical service staff members of the Company who play a large role in the design and development of new products, often in direct response to anticipated customer needs. This marketing/technical service combination has been the operating mode at Buttondown for many years and has been an important factor in the Company's success. The Company feels that the strength, depth and momentum of its research and development program put it in the vanguard in the specialty starch, adhesives and resins areas, and it feels that it is the product leader

in this sector. Expenses for research and product development (as defined in FASB No. 2) aggregated $6.2 million in 1976 versus $5.8 million in 1975. Approximately 160 members of the technical staff hold one or more chemical, chemical engineering or other technical degrees.

Prospective competitors have found some difficulty in breaking through these apparently strong Buttondown relationships at the plant level. Suggested as evidence of the Company's strong position in some of the specialty areas is the substantially diminished activity of both CPC International and American Maize Products in the specialty starch market.

Product Development

The Company feels that although its principal products are sold to mature, relatively slow growth industries, a number of factors suggest increasing demand for its products in those areas. These include energy conservation considerations (particularly in the paper industry), pollution and effluent control (paper, food and textiles), and rising raw material prices. Examples of the growing uses for the Company's products are the range of cationic starches and polymers developed by Buttondown to increase throughput, improve sheet strength and thus contribute to substantial future savings in the paper industry (approximately 1.8 billion pounds of starch sold annually--most is currently of the unconverted commodity type) where the following factors are at work:

1) Developing world shortage of wood fibers which necessitates use of lower-cost feed stock as well as sawdust and waste paper

2) A trend toward lighter weight paper to offset increasing postal and freight costs which results in a loss in paper strength and throughput

3) Increasing capital cost of paper manufacturing which places a premium upon ability to increase machine efficiency

Buttondown has, over the years, generated a substantial percentage of its sales volume growth through the introduction of new or modified products. It has estimated that 60% of 1976 sales were represented by products which the Company did not sell ten years earlier. The Company foresees, as an example, major new uses for its products in the fast food area as that industry matures and cost pressures begin to mount.

Organization and Management

The Buttondown Corporation Parent Company (58% of total Company sales in 1976) is organized into two major divisions which correspond to the major product lines of the firm: 1) Adhesives and 2) Resins and Starches. Each division is headed by an Executive Vice-President who reports directly to the President. Each division contains its own manufacturing, marketing and research and development group. Additionally, a Corporate Group coordinates planning and has responsibility for longer range research and development. Research and development committees from each division and the Corporate Group meet on a continuing and organized basis to facilitate information flow. Marketing is managed on a product basis; however, certain overlaps exist as to responsibility. The Resins and Starch Division, as an example, is responsible for paper industry marketing, although

products from Adhesives are also sold to that industry. Divisions do their own budgeting and internal control.

Domestic subsidiaries are managed in a relatively decentralized manner, reflecting the basic strength of management in most of the Company's acquisitions (final management responsibility rests with the Corporate Group). Quarterly executive review and pre-directors meetings bring together top level management. Key Company management meets with the outside directors (of which there are seven, including Donald J. Donahue, Vice Chairman, Continental Group, Inc., a recent addition) between board meetings.

International subsidiaries (approximately 60% of foreign sales are in Canada) and joint ventures are generally managed by native personnel (of the corporate venture partner when applicable). It has been the Company's policy to seek strong venture partners with quality management to which Buttondown could contribute technology. Several of the joint ventures involve royalty fee arrangements in the 3-5% of sales area (see Exhibit XX).

The Company feels that the keys to its management success include:

1) Liberal compensation system, including a discretionary bonus program based upon profitability; there are also separate special awards for achievement.

2) "Excitement" and dynamics of the business, e.g. turnover of products and the Company's position at the leading edge of research and development in the industry.

3) Promotion from within.

Financial Performance

The Buttondown Corporation has made money in every year since 1929 and has paid a cash dividend in every year since the policy was instituted in 1942. The following table sets forth latest 12 months levels and compound growth rates for net sales, gross profit, EBIT, net income, net income per share and cash dividends per share:

	Twelve Months Ended Sept. 30, 1977	Compound Growth Rates	
	(Millions except per share figures)	10-Yr.	5-Yr.
Net Sales	$364.8	13.8%	17.3%
Gross Profit	104.3	12.1%	13.4%
Earnings Before Interest and Taxes	48.1	12.7%	15.1%
Net Income	24.9	13.4%	12.3%
Net Income Per Share	$3.80	12.7%	11.6%
Cash Dividends Per Share	1.03	5.9%	9.0%

(See Exhibit XIII for ten-year summary of selected financial statistics as well as Exhibit I). The Company's capitalization balance is about in line with major industry participants (e.g., A.E. Staley, Loctite, see Exhibit XI) and the 5 3/4% subordinated convertible debentures due 2000 which were called on April 4, 1977 (redemption price of 105.46%) were rated Baa by Moody's (the redemption premium cost nets to $.14/share against 1977 earnings).

The estimated contribution of each of the Companies three major product categories to the consolidated sales of Buttondown and its consolidated subsidiaries in each of the five years ended December 31, 1976 was approximately as follows:

	1972	1973	1974	1975	1976
Adhesives and Related Products	40%	40%	39%	40%	40%
Starches and Related Products	37	38	40	39	39
Specialty Chemical Products	23	22	21	21	21
	100%	100%	100%	100%	100%

Since Company operations are interrelated through use by one activity of the production of another and through the practice of having marketing and sales staffs which serve important customer industries handle all categories of products, a similar estimate of the relative contribution of each of the categories to profits has not generally been practicable.

However the following represents a product line breakdown as to sales, costs and profitability for the year ended December 31, 1976 for operations of the Parent Company. 1976 is the first year that Buttondown has employed segment accounting:

	Product Lines					
	Adhesives		Starches		Resins & Chemicals	
	Amount	%	Amount	%	Amount	%
Net Sales	$93.8	100.0%	$94.2	100.0%	$33.9	100.0%
Direct Costs	55.2	58.8	48.0	51.0	19.0	56.0
Incremental Profit	38.6	41.2	46.2	49.0	14.9	44.0
Divisional Profit	17.9	19.1	21.4	22.7	5.6	16.5
Corporate Expense	5.4	5.8	4.7	4.9	1.6	4.7
Operating Income	$12.4	13.3%	$16.8	17.8%	$3.9	11.8%

Additionally, Exhibit XVIII shows the Company's first attempt at a breakdown of net income by product, by subsidiary.

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The Company's rate of return on average equity has consistently been in the 15-20% range over the past ten years and was 16.1% for the 12 months ended September 30, 1977 (see Exhibit XIII). Operating income (as a % of sales) margins over the past 5 years have held in the 11-15% range while net income margins (as a % of sales) have moved down slightly from the area of 8% to 6.8% for the latest 12 months period (see Exhibit III.) Exhibits XVII and XVIII show that the bulk of sales and profitability are derived from Buttondown Corporation Parent Company operations, followed by international subsidiaries (the bulk of which is the Canadian subsidiary), domestic subsidiaries and earnings from joint ventures. Over the most recent 5-year period, margins have remained relatively steady in the Parent Company, while among the major sales contributors, Proctor Chemical margins have remained strong while operating income margins in the major Canadian subsidiary (Naoan Products Limited) have decreased measurably during 1975-1977. Several other international subsidiaries and joint ventures have also experienced some margin squeeze over this period. It is worthwhile to note that operating margins for several of the Company's newer product lines (small as a % of total sales) are quite encouraging, particularly Seasonings, Inc., Ablestik Laboratories, Inc. and Permabond International.

Related Financial Matters

Buttondown management forecasts some substantial capital additions during the next two fiscal years—in the area of $20 million per year (expenditures were $14.9 million in 1976 and $19.1 million in 1975). The Company estimates in its Replacement Cost information (unaudited) that the current replacement cost of

net productive capacity (historical cost basis: $88.3 million) is $153.6 million. The Company's pension plans were fully funded at December 31, 1976. The Company is currently negotiating a private placement of $18 million of 20-year notes directly with Aetna and State Farm. Approximately $7 million of the proceeds will be used to pay out a revolving bank credit. Goodwill resulting from acquisition, mostly since 1970, aggregated $9.3 million at December 31, 1976. Street earnings estimates for the year ending December 31, 1977 are in the $4.00 range with estimates for 1978 at the $4.30 level.

Company Projections

The Company has estimated that the range of probable fourth quarter earnings is $.95 to $1.05 which would put year-end earnings in the $4.01 to $4.11 range. Prospects for 1978 are currently estimated to be an 8% increase in sales resulting in a 10% increase in net income $4.41-$4.42 earnings per share area). These estimates are based upon:

1) An assumption of 3-4% real economic growth in 1978

2) Flat or improved performance in Canada and Europe (the Company hopes for 8% sales increase)

3) A net reduction in the cost base for the Company of "waxy" corn (1977 corn crop was brought in at a substantially lower cost than 1975); the Company's corn cost basis reflects two years' crops at any one time.

4) The effect of some operating leverage

5) Increased profitability from several of the subsidiaries

The Company also sees 1979 as a good year based upon preliminary estimates (assuming a non-recessionary economic climate). Increased starch capacity, a Permabond plant coming on stream in 1978 and the development of meaningful sales and earnings in the anaerobic adhesives area should contribute to improved earnings.

Structure of the Transaction

The structure that has been proposed for the acquisition of Buttondown would involve a tax-free exchange of low dividend nonvoting preferred shares of a subsidiary of Unilever U.S. ("Newco") for shares of Buttondown contemporaneous with a reverse subsidiary cash merger involving a subsidiary of Newco and Buttondown (capital contribution of cash made by Unilever). The transaction would be an offer to all shareholders with the terms of the preferred set such that only low-basis shareholders would likely find the security attractive. A 4% dividend rate has been mentioned by Lazard. Liquidation preference of the shares would be equal to price to price per share paid in connection with the cash merger and 2/3 of the holders of the preferred stock could elect 51% of the directors of the Company in the event of default under the terms of the preferred. Holders of the preferred would be allowed to optionally redeem shares at any time after the minimum holding period of five years (minimum for tax-free treatment under Section 351); Newco could optionally redeem starting 20 to 30 years after issuance. The tax-free nature of the exchange offer depends upon the transaction standing as a discrete exchange of property under Section 351 of the

IRC. The firms of Cravath, Swaine & Moore (representing Unilever) and Debevoise, Plimpton, Lyons & Gates (representing Buttondown) have reviewed the tax implications of the transaction and have sought IRS staff guidance at the group chief level. No negative comments have been received; however, it is clear that a tax ruling will have to be obtained on this matter.

Several key questions arise as to the exchange of this preferred stock:

1) How many holders would be inclined to take the preferred?

2) What assets (credit) will be available to secure the preferred as to dividend and probable redemption?

3) How can liquidity for this security be generated in the near term?

Prospective Preferred Holders

The profile of individual shareholders provided by the Company suggests that as many as approximately 1.64 million shares or about 25% of the common stock of Buttondown might be exchanged for the preferred stock (see Exhibit VIII). This would create an outstanding principal amount of preferred stock in the Newco holding company of as much as approximately $115 million. If only Mr. and Mrs. Greenwall were to exchange their shares (1 million shares), approximately $70 million of preferred would be created.

Assets (Credit) Available for Dividend Service and Redemption

The structure which has been tentatively agreed upon by Unilever would provide for the contribution by Unilever (to the Newco holding company) of sufficient funds, in addition to the funds required for the cash merger, to allow redemption of 100% of the aggregate liquidation value of the preferred stock. The funds so contributed would then be protected in Newco by a set of restrictive covenants that would, in effect, "lock" the redemption funds into Newco. Since the funds may not be specifically segregated for the benefit of the preferred holders (i.e., the assets of the company are held for the benefit of all shareholders; a segregation would disallow the tax-free treatment for those receiving the preferred) substantial restrictive covenants have been designed for Buttondown Corporation. Such covenants (which have been designed along the lines of an "A" credit) would protect the asset base in the case of default and enhance the ongoing security of the preferred shareholders. Lazard and Unilever are agreeable as to the 100% cash contribution but oppose the restrictive covenants at the Company level.

Other options for securing the servicing of the preferred and funds for redemption include:

1. a subscription agreement with Unilever U.S. guaranteed by Unilever
2. a Unilever guarantee on all the financial obligations of Buttondown such that no creditor of Buttondown would attempt to restrict or attach the redemption funds in

Newco should Buttondown develop financial difficulty

3. A covenant restricting Newco such that net tangible assets of Newco could not be less than the greater of (1) twice the liquidation value of the then outstanding preferred stock or (2) the liquidation value of the then outstanding preferred stock plus $50 million.

Liquidity for Preferred Shares during the Waiting Period

While no discussions have been held with a commercial bank, it is expected that the preferred stock would be a "bankable security". It is the Team's preliminary view that if cash equal to the redemption value of the preferred is "sterilized" in Newco and cash cannot be leaked out, this fact plus the moral obligation of Unilever to reduce the preferred should permit holders to borrow against the security.

Prospective Business Combinations

The Company was approached by and progressed substantially toward a deal with Merck & Co. in 1970. It is thought by Buttondown management that the terms of the transaction would have included a tax-free exchange of common stock with certain provisions as to continuity of management. Mr. Greenwall and management currently feel that a tax-free transaction involving a U.S. acquiror in the oil, chemical, forest products, pharmaceuticals or consumer products businesses would not be unacceptable. Greenwall and management are extremely sensitive as to the future prospects for personnel in the Company and are very interested in Buttondown retaining strategic autonomy in a business sense. Management also feels

that some synergy may exist with the Unilever organization given a) the nature of the Unilever chemical, paper, plastics and packaging operations (U.K., Netherlands, Australia, South Africa, Germany) and b) the strong consumer products orientation of Unilever United States, Inc. (sales and net income for the year ended December 31, 1976—$1.15 billion and 40.1 million respectively; see consolidated financial statements for Unilever United States, Inc., at Exhibit XXIII).

A summary analysis of U.S. companies with which Buttondown might combine utilizing a tax-free exchange of shares is found at Exhibit XIV. The criteria for inclusion of prospective acquiror companies are:

1) Engaged in the oil, chemical, forest products, pharmaceutical or consumer products business
2) Transaction would result in less than 10% earnings per share dilution for the acquiror
3) Market value of the acquiror greater than or equal to $750 million.

[Exhibit 15-O]

EXHIBIT XV

PROJECT BUTTONDOWN

Buttondown Corporation

Analysis of Customers of Buttondown Corporation(1)

	Nine Months Ended September 30, 1977	
	Amount (000)	%
Net Sales	$279,215	100.0%
Procter & Gamble	7,161	2.6
International Paper	4,181	1.5
Crown Zellerbach	3,974	1.4
Johnson & Johnson	3,787	1.4
Scott Paper	3,382	1.2
Westvaco	2,782	1.0
Kimberly Clark	2,206	0.8
Weyerhaeuser Co.	2,090	0.7
Georgia Pacific	1,889	0.7
Kraftco Corp.	1,882	0.7
Campbell Soup	1,800	0.6
Champion International	1,587	0.6
Boise Cascade	1,575	0.6
Gerber Products Co.	1,492	0.5
Owens Corning	1,406	0.5
Anderson Corp.	1,349	0.5
Bemis Co.	1,250	0.4
Mead Corp.	1,212	0.4
Continental Can	1,162	0.4
American Can	1,128	0.4
Federal Paper Board	1,099	0.4
Beatrice Foods	1,074	0.4
General Foods	1,061	0.4

H. J. Heinz	1,059	0.4
Hammermill Paper	995	0.4
St. Regis Paper	969	0.3
ITT Continental Baking	931	0.3
Agway Inc.	928	0.3
Borden Co.	887	0.3
Mobil Oil Corp.	858	0.3
	$ 57,156	20.4%

NOTE: (1) Companies listed are the top 30 Button-down Corporation customers. These are Parent company customers only.

kmf:mdh:RBE:2/15/78

[Exhibit 20-T]

MORGAN STANLEY & CO.
Incorporated
1251 Avenue of the Americas
New York, N.Y. 10020

July 10, 1978

Board of Directors
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Sirs:

National Starch and Chemical Corporation ("National") has entered into an agreement with Unilever United States, Inc. ("Unilever U.S."), a wholly-owned subsidiary of Unilever N.V. (Unilever N.V. and Unilever Limited are the parent companies of the Unilever Group, which is herein collectively called "Unilever"), National Starch and Chemical Holding Corporation ("Holding"), a wholly-owned subsidiary of Unilever U.S., and NSC Merger, Inc. ("Subsidiary"), a wholly-owned subsidiary of Holding, providing for the acquisition of National through the consummation of a merger (the "Merger") under which Subsidiary will merge into National. The Merger is conditioned upon and will be immediately preceded by completion of an exchange offer (the "Exchange Offer") to National stockholders by Holding.

The terms of the proposed transactions are set forth in the Proxy Statement and in the Prospectus attached thereto, each dated the date hereof, expected to be mailed to National stockholders as soon as practicable hereafter and in the "Agreement and Plan of

Merger" which appears as Annex I to the Proxy Statement. The terms of the proposed Merger provide that a cash payment of $73.50 per share will be made to all holders of shares of National, other than holders who have deposited shares in the Exchange Offer and other than Holding. The terms of the proposed Exchange Offer provide that stockholders who deposit shares for exchange pursuant thereto will receive shares of $3.31 Preferred Stock of Holding ($73.50 liquidation value) on a share-for-share basis. Upon completion of the Exchange Offer together with the consummation of the ensuing Merger, National will become a wholly-owned subsidiary of Holding. All National stockholders may therefore elect either the $73.50 per share cash proceeds of the proposed Merger or the Preferred Stock of Holding, such stock to be issued on a share-for-share basis. You have asked for our opinion as to whether the terms of the proposed Merger and related Exchange Offer taken as a whole are fair and equitable to the National stockholders from a financial point of view.

In connection with our review of the proposed transactions we have studied, among other things, National's earnings, cash flow, dividends and book value, both in the aggregate and on a per share basis, as well as National's current capitalization. We have studied the consolidated financial statements for recent years and for interim periods to date and other relevant financial and operating data for National available from published sources and internal records. We have also reviewed internal financial projections for National and discussed the business and prospects of National with certain of National's management and we have visited certain of National's facilities. We

have analyzed published information of certain other companies, have compared National from a financial point of view with these other companies and have reviewed the terms of comparable business combinations. We have also reviewed the stock market trading price range of National's Common Stock from 1972 to date and have compared these data with statistics for other comparable companies and with market indices. We have read the Proxy Statement and the Prospectus referred to above and the "Agreement and Plan of Merger" which appears as Annex I to the Proxy Statement and we have relied upon the information supplied by National, Unilever U.S. and Unilever contained therein.

We have reviewed the proposed financial structure of Holding and have reviewed certain financial information furnished to us by Unilever U.S. including, among other things, the earnings, cash flow, book value and current capitalization both of Unilever U.S. and of its constituent companies, Thomas J. Lipton, Inc. ("Lipton") and Lever Brothers Company ("Lever"). We have also discussed the business and prospects of Lipton and Lever as well as those of Unilever with certain of their respective management.

We have made such other analyses and examinations as we have deemed necessary.

We have not independently verified the information concerning National, Unilever U.S. or Unilever or other data which we have considered in our review, except as indicated herein, and for purposes of the opinion set forth below we have assumed the accuracy of all such information.

Based upon the foregoing, we are of the opinion that the terms of the proposed Merger and related Exchange Offer taken as a whole are fair and equitable to the National stockholders from a financial point of view.

Very truly yours,

MORGAN STANLEY & CO. INCORPORATED

By Robert F. Greenhill
Managing Director

[Exhibit 21-U]

NATIONAL STARCH AND CHEMICAL CORPORATION
10 Finderne Avenue
Bridgewater, New Jersey 08807

July 10, 1978

Dear Stockholder:

A Special Meeting of Stockholders of the Company, in lieu of the Annual Meeting, will be held on August 15, 1978, as set forth in the Notice of Special Meeting of Stockholders, to vote upon an Agreement and Plan of Merger providing for a merger under which the Company would become a subsidiary of National Starch and Chemical Holding Corporation ("Holding"), a newly incorporated subsidiary of Unilever United States, Inc., which is wholly-owned by Unilever N.V., all as described in the attached Proxy Statement. Upon the merger, which is subject to the approval of the holders of two-thirds of the outstanding shares of the Company's Common Stock, holders of Common Stock of the Company would receive a cash payment of $73.50 per share. At the Special Meeting, stockholders will also vote for the election of directors and the ratification of the appointment of auditors.

After careful consideration, the Board of Directors of the Company believes that the approval of the proposed merger is in the best interests of stockholders and that the terms of the proposed merger are fair and equitable. The Board of Directors therefore recommends that you vote FOR the merger proposal as set forth in the Notice of Special Meeting of Stockholders.

Anna A. and Frank K. Greenwall, who own beneficially in the aggregate 944,436 shares of Common Stock of the Company, or approximately 14.4% of the outstanding shares, have indicated their support for the merger and have agreed to vote such shares for and against the proposed merger in the same proportion as the vote cast by all other stockholders voting upon the merger. Mr. Greenwall is a Director and Chairman of the Executive Committee of the Company.

The enclosed Proxy Statement more fully describes the proposed merger, its terms and related information, and you are urged to study carefully the Proxy Statement and each of the annexes.

Attached to the Proxy Statement is an Exchange Offer prospectus by Holding. Under the Exchange Offer, all stockholders are being offered the alternative of exchanging their shares of the Company, immediately prior to the effectiveness of the merger, on a tax-free basis, for shares of a newly issued non-voting preferred stock, with a par value of $73.50 per share and cumulative annual dividend of $3.31 per share (4.5% per annum), of Holding. As a result of the merger, in which a subsidiary of Holding will be merged into the Company, Holding will own all the shares of the Company. The preferred stock, which is restricted as to transferability and will not be listed, is subject to mandatory and optional redemption as more fully described in the Exchange Offer. The attached Exchange Offer prospectus more fully describes the proposed Exchange Offer, its terms and related information, and you are urged to study the prospectus carefully. Your attention is directed in particular to the discussion in the Exchange Offer of federal income taxes and the desirability of consulting a tax advisor.

Stockholders whose shares are exchanged pursuant to the Exchange Offer will not participate in the merger with respect to such shares and, therefore, will not receive $73.50 per share in cash upon consummation of the merger. **However, all stockholders of record on July 10, 1978, even if participating in the Exchange Offer, are entitled to vote on the merger proposal.** The Exchange Offer will not be consummated unless the merger has been approved by holders of two-thirds of the outstanding shares of the Company's Common Stock and all other conditions to the merger have been satisfied or waived. The conditions to the consummation of the merger and the Exchange Offer are described in the enclosed Proxy Statement and Exchange Offer prospectus.

You are urged to vote FOR the proposals to be presented to the Special Meeting of Stockholders as set forth in the Notice of Special meeting of Stockholders and, if you do not expect to be at the Meeting, please mark, sign and mail the enclosed proxy in the enclosed self-addressed envelope as soon as possible.

Sincerely,

/s/ Donald D. Pascal

Chairman

/s/ Carlyle G. Caldwell

President and Chief
Executive Officer

NATIONAL STARCH AND CHEMICAL CORPORATION

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
(IN LIEU OF ANNUAL MEETING)
To be held August 15, 1978

To the Stockholders:

NOTICE IS HEREBY GIVEN that a Special Meeting of the Stockholders of NATIONAL STARCH AND CHEMICAL CORPORATION (the "Company") will be held at Bankers Trust Company, 280 Park Avenue, New York, New York, on August 15, 1978, at 10 A.M., New York time, for the following purposes:

(1) To consider and vote upon the adoption of the Agreement and Plan of Merger, dated as of March 16, 1978 (a copy of which is attached to the accompanying Proxy Statement as Annex I), which provides for the merger of NSC Merger, Inc. (a wholly-owned subsidiary of National Starch and Chemical Holding Corporation which in turn is a subsidiary of Unilever United States, Inc.) into the Company and the payment to the holders of the Company's Common Stock (other than National Starch and Chemical Holding Corporation) of $73.50 in cash for each of their shares, all of which will be cancelled.

(2) To elect 10 directors to serve until the next Annual Meeting of Stockholders and until their successors have been duly elected and qualified.

(3) To consider and vote upon a proposal to ratify the action of the Board of Directors in appointing Main Lafrentz & Co. as accountants to

audit the accounts and records of the Company and certify the financial statements of the Company for the year 1978.

(4) To transact such other business as may properly come before the meeting or any adjournment thereof.

Holders of record of the Common Stock of the Company at the close of business on July 10, 1978, are entitled to vote at the meeting.

By order of the
Board of Directors,

HERBERT J. BAUMGARTEN
Vice President and
Secretary

10 Finderne Avenue
Bridgewater, New Jersey 08807
July 10, 1978

If you do not expect to be present at the meeting, please mark, date and sign the enclosed form of proxy and return it in the enclosed postage-paid envelope.

IF YOU DO NOT MARK YOUR PROXY FOR OR AGAINST THE MERGER, IT WILL BE VOTED FOR THE MERGER.

NATIONAL STARCH AND CHEMICAL CORPORATION

PROXY STATEMENT

INTRODUCTION

General

This Proxy Statement is being furnished to the stockholders of National Starch and Chemical Corporation (the "Company") in connection with the solicitation of proxies by the Company's management for use at the Special Meeting of Stockholders, in lieu of the Annual Meeting, and at any adjournment thereof, called for the purposes set forth in the accompanying Notice of Special Meeting. Mailing of this Proxy Statement and the accompanying form of proxy to the stockholders is to be commenced on July 11, 1978. The address of the Company's principal executive offices is 10 Finderne Avenue, Bridgewater, New Jersey 08807.

The Company has entered into an Agreement and Plan of Merger, dated as of March 16, 1978 (the "Merger Agreement"), among the Company, NSC Merger, Inc. ("Subsidiary"), Unilever United States, Inc. ("Unilever U.S.") and National Starch and Chemical Holding Corporation ("Holding"), a copy of which is attached as Annex I to this Proxy Statement. Under the Merger Agreement, a merger (the "Merger") would take place whereby the Company would become a wholly-owned subsidiary of Holding, which in turn is a subsidiary of Unilever U.S., and the stockholders of the Company (other than Holding) would receive $73.50 per share in cash. The terms of the Merger are set out more fully herein under the heading "The Proposed Merger—Terms of the Merger". Consummation of the Merger is subject to the fulfillment or waiver of certain conditions at the filing of the Merger Agreement pursuant to Delaware law. See "The Proposed Merger—Conditions to the Merger" and "The Proposed Merger—Amendment or Termination of the Merger Agreement or Waiver of Conditions", below.

The holders of the Company's Common Stock have the right to dissent from the Merger and demand appraisal of their shares. To exercise such right, a stockholder must file a written demand for appraisal *prior* to the vote on the Merger at the Special Meeting. Such right would be waived by voting or giving a proxy in favor of the Merger or by delivering an unmarked proxy. See "The Proposed Merger—Appraisal Rights of Dissenting Stockholders", below.

Attached to this Proxy Statement is a prospectus relating to an exchange offer (the "Exchange Offer") by Holding to issue one share of its new non-voting preferred stock, par value $73.50 per share, entitled to cumulative annual dividends at the rate of $3.31 (4.5% per annum) per share (the "Holding Preferred Stock"), in exchange for each share of Company Common Stock tendered pursuant to the Exchange Offer. Stockholders whose shares of Company Common Stock are exchanged will *not* receive $73.50 in cash for such shares; however, all stockholders of record on July 10, 1978, even if participating in the Exchange Offer, are entitled to vote on the Merger proposal. The Exchange Offer will not be consummated unless all conditions to the Merger have been satisfied or waived.

At the Special Meeting, the stockholders will elect 10 directors to hold office until the election of directors at the next Annual Meeting of Stockholders. If the Merger is consummated, it is the present intention of

Holding that the 10 directors who are elected will be invited to remain in office. See "Election of Directors", below, for a list of the nominees for director and other information concerning directors and officers.

The stockholders are also being asked to vote upon a proposal to ratify the action of the Board of Directors of the Company in appointing Main Lafrentz & Co. as accountants to audit the accounts and records of the Company and certify the financial statements of the Company for the year 1978. See "Appointment of Auditors", below.

Date, Time and Place of Special Stockholders' Meeting

The Special Meeting of Stockholders of the Company will be held on August 15, 1978, at 10:00 A.M., New York time, at Bankers Trust Company, 280 Park Avenue, New York, New York.

Record Date; Voting

The close of business on July 10, 1978, has been fixed as the record date for the determination of holders of outstanding shares of Company Common Stock entitled to notice of and to vote at the Special Meeting of Company stockholders. On that date there were issued and outstanding 6,563,930 shares of Company Common Stock, each entitled to one vote per share.

The approval of the Merger will require the affirmative vote of two-thirds of the outstanding shares of Company Common Stock. See "The Proposed Merger—Agreement with the Principal Stockholders", below, as to the agreement by holders of 14.4% of the

outstanding shares to vote for and against the Merger in the same proportion as all other stockholders voting on the Merger.

A plurality of the votes cast, either in person or by proxy, is necessary to elect directors, and a majority of the votes cast, either in person or by proxy, is necessary to ratify the appointment of Main Lafrentz & Co. as the Company's independent auditors.

Shares represented by properly executed and unrevoked proxies will be voted at the Special Meeting in accordance with the directions contained therein. **If no direction is made with respect to the Merger, the election of directors or the ratification of the appointment of auditors, the shares represented by such proxy will be voted (1) for adoption of the Merger Agreement, (2) for the election as directors of the nominees named below, or (3) for ratification of the appointment of Main Lafrentz & Co. as auditors of the accounts of the Company, as the case may be.** A stockholder executing and returning a proxy has the power to revoke it at any time before it is exercised. Such revocation, to be effective, must be either communicated in writing to the Secretary of the Company or effected by attendance at the meeting.

Proxy Solicitations

The cost of proxy solicitations will be borne by the Company. In addition to solicitations of proxies by use of the mails, some officers or employees of the Company, without extra remuneration, may solicit proxies personally or by telephone. In addition, Georgeson & Co., a proxy solicitation firm, has been retained to assist in the solicitation of proxies. The charges of

such firm are estimated at $5,000, plus expenses. The Company will also request brokers, dealers, banks, and their nominees to solicit proxies from their clients, where appropriate, and will reimburse them for reasonable expenses related thereto. See "The Proposed Merger—Expenses", below.

THE PROPOSED MERGER

The detailed terms of, and conditions to, the Merger are set forth in the Merger Agreement, which is attached to this Proxy Statement as Annex I. The statements made in this Proxy Statement are qualified by, and made subject to, the more complete information set forth in the Merger Agreement.

All information contained in this Proxy Statement with respect to Subsidiary, Holding, Unilever U.S., Unilever N.V., Unilever Limited and the Exchange Offer has been supplied by Unilever U.S. for inclusion herein.

Parties to the Merger Agreement

The parties to the Merger Agreement are the Company, Unilever U.S., Holding and Subsidiary.

Unilever U.S., a Delaware corporation and a subsidiary of Unilever N.V., a Netherlands corporation, will, upon consummation of the Exchange Offer and the Merger, own all of the common stock of Holding. All of the Holding Preferred Stock will be held upon consummation of the Merger and the Exchange Offer by former stockholders of the Company who have exchanged their Company Common Stock for Holding Preferred Stock in the Exchange Offer. Unilever U.S.

is also the holder of all the outstanding voting stock of Lever Brothers Company and of Thomas J. Lipton, Inc. See "Unilever Group of Companies" in the Exchange Offer prospectus.

Holding, a Delaware corporation, has been recently organized for the purpose of participating in the proposed Merger and Exchange Offer. Upon the consummation of such transactions, Holding will own all of the Common Stock of the Company and certain other securities. See "National Starch and Chemical Holding Corporation and Subsidiaries" in the Exchange Offer prospectus.

Subsidiary was organized as a wholly-owned Delaware subsidiary of Holding solely for the purpose of effecting the Merger. All of the outstanding capital stock of Subsidiary is owned by Holding. The sole asset of Subsidiary is $1,000, and it has no liabilities other than its obligations under the Merger Agreement.

All of the expenses incurred by Unilever U.S., Holding and Subsidiary in connection with the Merger will be paid by Unilever U.S.

Terms of the Merger

Under the Merger Agreement, Subsidiary will merge with and into the Company, which will be the surviving corporation. Effective upon the Merger:

(1) all of the outstanding shares of the Company's Common Stock (other than treasury shares and shares referred to in (3) below) shall be cancelled and each holder of such Common Stock will be entitled to receive $73.50 in cash for each share held (see "The Proposed Merger—Ex-

change of Company Common Stock Certificates for Cash", below);

(2) each share of Subsidiary's common stock (all of which are held by Holding) shall be converted into one share of common stock of the surviving corporation, without any action on the part of or payment to Holding;

(3) all shares of the Company's Common Stock held by Holding (which will be shares, if any, acquired in the Exchange Offer) shall be cancelled without any payment to Holding; and

(4) all of the Company's then outstanding employee stock options and stock incentive award units issued pursuant to the Company's stock option and incentive plans shall be cancelled and each holder of any thereof shall be entitled to receive a cash payment in the amount and at the time specified in the agreement entered into by such employee and the Company (see "The Proposed Merger—Arrangements with Employees of the Company", below).

Under the Merger Agreement, the Merger will become effective (the "Effective Time") at midnight ending the day of the filing (the "Filing Time") of the Merger Agreement pursuant to Delaware law. It is anticipated that, if the Merger Agreement is approved at the Special Meeting, the filing will take place on August 15, 1978 or on such later date as the parties to the Merger Agreement may agree (but not later than October 30, 1978). The stock transfer books of the Company will be closed at the close of business on the day of such filing and thereafter no transfer of record

of certificates representing shares of Company Common Stock will be made.

Under the Merger Agreement, Unilever U.S. will, immediately prior to the Filing Time, make a contribution to Holding of an amount (the "Unilever U.S. Payment") equal to $73.50 times the number of shares of Company Common Stock then outstanding (including shares tendered to Holding in the Exchange Offer), plus the amount payable in connection with the Merger to employees in respect of stock options (and certain shares issued upon exercise of stock options) and stock incentive award units. Up to 15% of such contribution may be represented by an irrevocable letter of credit of a major New York bank, and the balance will be made in cash. Unilever U.S. intends to deliver such a letter of credit drawn on Morgan Guaranty Trust Company of New York in an amount equal to 15% of such contribution.

At the Effective Time, Subsidiary will cease to exist; the Company will be the surviving corporation and will retain its present name. The certificate of incorporation and by-laws of the Company, as in effect immediately prior to the Effective Time, will become the certificate of incorporation and by-laws of the surviving corporation (except that the authorized capital stock of the surviving corporation will be reduced to 1,000 shares of Common Stock and certain provisions no longer relevant will be deleted) and the directors and officers of the Company as of the Effective Time will continue as the directors and officers of the surviving corporation.

If the Merger is consummated, each stockholder will have no further rights with respect to Company Common Stock other than to receive the cash price of

$73.50 per share **unless such stockholder has dissented in accordance with applicable Delaware law.** See "The Proposed Merger—Appraisal Rights of Dissenting Stockholders", below.

The exchange by Holding of shares of Company Common Stock tendered pursuant to the Exchange Offer for shares of Holding Preferred Stock will take place at the Filing Time. Consequently, holders of Company Common Stock whose shares are exchanged will not be holders of such shares at the Effective Time and will not receive any payment for such shares as a result of the Merger **nor will they have any appraisal rights with respect to such shares.**

Exchange of Company Common Stock Certificates for Cash

Each stockholder (other than Holding) as of the Effective Time will be entitled to receive $73.50 for each share then held by him which has not been exchanged for Holding Preferred Stock in the Exchange Offer, against delivery of the certificates representing such shares. As a condition to the effectiveness of the Merger, Holding will, out of the Unilever U.S. Payment, cause Subsidiary to deliver to Morgan Guaranty Trust Company of New York, 23 Wall Street, New York, New York (the "Disbursing Agent"), an amount equal to $73.50 times the number of shares of Company Common Stock then outstanding which have not been exchanged for Holding Preferred Stock in the Exchange Offer. Such amount shall be delivered in cash except than an amount equal to up to 15% of the Unilever U.S. Payment may be represented by the irrevocable letter of credit referred to under "The Proposed Merger—Terms of the Merger". After the

Effective Time, Unilever U.S. may contribute additional cash to the Disbursing Agent to be used in lieu of the letter of credit.

Promptly after the Effective Time, the surviving corporation will mail to each stockholder of record as of the Effective Time (other than Holding) a letter of transmittal to be used by such stockholder in surrendering certificates which, prior to the Merger, represented shares of Company Common Stock. Letters of transmittal will also be available beginning on the banking day immediately following the Effective Time at the office of the Disbursing Agent, Corporate Trust Department, 15 Broad Street—13th Floor, New York, New York. Payments in respect of certificates duly surrendered prior to 10:30 A.M. on any banking day will normally be made on the same day and payments in respect of certificates duly surrendered after 10:30 A.M. will normally be made on the following banking day. After the Effective Time there shall be no registration of transfers on the stock transfer books of the Company with respect to Company Common Stock.

The amount so deposited with the Disbursing Agent remaining unclaimed after six months (except the portion thereof attributable to shares held by dissenting stockholders) will be transferred to the surviving corporation. Thereafter the Disbursing Agent will have no liability to any holder of unsurrendered certificates representing Company Common Stock (other than dissenting stockholders), but the surviving corporation will be obligated, upon surrender to it of any such unsurrendered certificates, to pay to the holder thereof $73.50 per share in cash. All interest accruing with respect to any cash held by the Disbursing Agent

for the making of such payment to the holders of certificates representing Company Common Stock shall be for the account of the surviving corporation, and no interest will be accrued or payable to any holder of any such certificates.

Conditions to the Merger

In addition to the approval of the Company's stockholders required by the Merger Agreement, the consummation of the Merger is subject to certain other conditions. **Under the Merger Agreement, such conditions may be waived, amended or modified as provided therein (see "The Proposed Merger—Amendment or Termination of the Merger Agreement or Waiver of Conditions" below).**

The obligations of Unilever U.S., Holding and Subsidiary are subject, at their option, to the conditions, among other things, that at the Filing Time:

(a) this Proxy Statement (other than with respect to the descriptions of Unilever U.S., Holding and Subsidiary and the Exchange Offer) shall not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading to the stockholders of the Company or to Unilever U.S., Holding or Subsidiary.

(b) since the date of this Proxy Statement, there shall have been no material adverse change in the condition, financial or otherwise, or the results of operations of the Company and its subsidiaries taken as a whole;

(c) there shall be no pending or threatened action or proceeding by or before any court or other governmental body to restrain or invalidate the Merger or the Exchange Offer or the formation of Holding and there shall be no governmental or judicial action, law or regulation making any thereof illegal or prohibiting or making unlawful the payment of cash or the exchange of shares of Holding Preferred Stock for the Company's Common Stock as contemplated by the Merger Agreement;

(d) the employment agreements and agreements with respect to cancellation of stock options and stock incentive award units discussed under "The Proposed Merger—Arrangements with Employees of the Company", below, shall be in effect;

(e) the Merger shall have been approved by all necessary corporate proceedings of the Company;

(f) the Filing Time shall have occurred prior to October 31, 1978;

(g) the representations and warranties by the Company contained in the Merger Agreement shall be true, and the obligations and covenants of the Company contained therein shall have been performed and complied with in all material respects;

(h) the agreement with certain principal stockholders attached as Annex III to this Proxy Statement shall have been performed and complied with by such stockholders; and

(i) there shall have been received opinions of counsel as to various aspects of the transactions contemplated by the Merger Agreement and a letter from the Company's accountants with respect to certain financial information contained in this Proxy Statement and the Exchange Offer prospectus.

The obligations of the Company under the Merger Agreement are subject, at its option, to the conditions referred to in clause (c), (e) and (f) in the description of the conditions above, and to the further conditions, among other things, that at the Filing Time:

(a) the representations and warranties made by Unilever U.S., Holding and Subsidiary contained in the Merger Agreement shall be true, and their obligations and covenants contained in the Merger Agreement shall have been performed and complied with in all material aspects;

(b) the Merger and the Merger Agreement shall have been approved by all necessary corporate proceedings of Holding and Subsidiary and the Exchange Offer shall have been approved by all necessary corporate proceedings of Holding;

(c) the Registration Statement with respect to the Exchange Offer shall be effective and the Holding Preferred Stock shall be qualified for offering and sale under the securities or "blue sky" laws of all jurisdictions in which there were holders of record of an aggregate of at least 1,000 shares of Company Common Stock on the record date for the Special Meeting; the Exchange Offer shall have been consummated on the terms set forth and as otherwise described in the Exchange Offer

prospectus attached hereto; and such Exchange Offer prospectus (except with respect to the description of the Company included therein) shall not contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading to the Company and the stockholders of the Company;

(d) no default shall exist under the terms of the Holding Preferred Stock being offered in the Exchange Offer;

(e) the shareholder's equity in Unilever U.S., without giving effect to the consummation of the Exchange Offer and the Merger, shall be not less than $350 million;

(f) the Agreement, dated as of March 16, 1978, between Unilever U.S. and Holding with respect to the disposition by Unilever U.S. of shares of common stock of Holding, the voting and redemption of shares of Holding Preferred Stock held by Unilever U.S. and the payment by Unilever U.S. of all taxes to which Holding is subject, shall be in full force and effect (see the description of such Agreement in the Exchange Offer prospectus-"Description of Holding Preferred Stock-Covenants");

(g) the various tax rulings described in "The Proposed Merger-Federal Income Tax Consequences", below, and in the Exchange Offer prospectus under "The Exchange Offer-Federal Income Tax Consequences", shall not have been withdrawn; and

(h) opinions of counsel as to various aspects of the transaction contemplated by the Merger Agreement shall have been received.

Amendment or Termination of the Merger Agreement or Waiver of Conditions

The Merger Agreement may be terminated and the proposed Merger abandoned at any time prior to the Filing Time, whether or not theretofore approved by the stockholders of any of the parties to the Merger Agreement, under any of the following circumstances:

(1) by the mutual consent of the Boards of Directors of the Company, Unilever U.S., Holding and Subsidiary; or

(2) by the Board of Directors of the Company if the conditions precedent to the Company's obligations under the Merger Agreement have not been fulfilled prior to October 31, 1978 and have not been waived by the Company; or

(3) by the respective Boards of Directors of Unilever U.S., Holding and Subsidiary if the conditions precedent to their obligations under the Merger Agreement have not been fulfilled prior to October 31, 1978 and have not been waived by them.

No such termination of the Merger Agreement will give rise to any liability on the part of any party thereto to any other party except with respect to provisions relating to confidentiality of information.

In addition, the Merger Agreement permits the parties thereto to waive compliance with the conditions to their respective obligations under the Merger

Agreement or to waive any inaccuracies in the representations and warranties contained therein. The Merger Agreement also provides that by mutual consent of their respective Boards of Directors (or the responsible officers authorized by such Boards), the parties to the Merger Agreement may amend or modify and supplement the Merger Agreement in writing, except that after the vote on the Merger by the stockholders of the Company, no such amendment, modification or supplement shall affect the rights of such stockholders in a manner which in the judgment of the Board of Directors of the Company is materially adverse to such stockholders.

Required Corporate Approvals

At a meeting held on March 16, 1978, the Board of Directors of the Company approved the Merger Agreement and, at a meeting held on July 10, 1978, the Company's Board of Directors directed that the Merger Agreement be submitted to the stockholders of the Company for a vote on its adoption.

On March 16, 1978, the respective Boards of Directors of Unilever U.S., Holding and Subsidiary approved the Merger Agreement. On July 7, 1978, Holding, as the sole stockholder of Subsidiary, approved the Merger Agreement by written consent.

Consummation of the Merger is subject to the affirmative vote of the holders of two-thirds of the Company's Common Stock outstanding at the record date. See "The Proposed Merger—Agreement with the Principal Stockholders", below.

Management of the Company After the Merger

The Company has been informed by Unilever U.S. and Holding that their present intention is to continue the management, operations and development of the Company, including its subsidiaries and joint ventures, as heretofore. Accordingly, the present officers of the Company will continue as officers of the surviving corporation and certain officers of the Company have entered into employment contracts which are effective upon consummation of the Merger. See "The Proposed Merger—Arrangements with Employees of the Company", below. Unilever U.S. and Holding will also ask the directors of the Company as of the date hereof who are nominees for election at the Special Meeting to continue as directors following the consummation of the Merger if reelected.

After the Merger, Holding, as the owner of all the issued and outstanding capital stock of the Company, will be able to make such changes in the composition of the officers and directors of the Company and its subsidiaries as Holding deems necessary or desirable from time to time. However, it is Holding's present intention that it will cause no change in the executive management of the Company or its subsidiaries unless such change is approved by their respective Boards of Directors.

Investment Banking Opinion

The Company's Board of Directors has retained the investment banking firm of Morgan Stanley & Co. Incorporated ("Morgan Stanley") to advise it regarding the terms of the proposed Merger and related Exchange Offer from a financial point of view. Morgan Stanley has advised the Company's Board of Directors

that in its opinion the terms of the Merger and related Exchange Offer taken as a whole are fair and equitable to the holders of the Company's Common Stock from a financial point of view. A copy of that opinion, which sets forth the factors considered and assumptions made, is attached as Annex IV.

Morgan Stanley has acted as financial adviser to the Company in connection with the Merger and Exchange Offer and assisted in the negotiation of the transactions on behalf of the Company. The Company has agreed to pay Morgan Stanley fees for its services as follows, depending on the outcome of the Merger proposals: (a) whether or not the Merger is consummated, $500,000 plus out-of-pocket expenses including reasonable counsel fees, and (b) in the event the Merger is consummated, in addition to the amount set forth in clause (a), $1,700,000. The Company has agreed to indemnify Morgan Stanley against certain liabilities in connection with the transactions contemplated by the Merger Agreement. Morgan Stanley has not previously acted as financial adviser or consultant to the Company and has advised the Company that, except for its fee, it has no interest in the Merger and Exchange Offer.

Reasons for the Merger

In early October 1977 a representative of Unilever U.S. met, at his request, with the Chairman of the Board and the Chairman of the Executive Committee of the Company to inquire as to possible interest in an acquisition of the Company. Discussions continued until a Letter of Intent was signed on December 11, 1977 by the Company and Unilever U.S. embodying the basic terms of the Merger and the Exchange Offer.

On March 16, 1978 the definitive Merger Agreement was signed.

The terms of the Merger and the Exchange Offer are the result of arm's-length negotiations between representatives of the Company and Unilever U.S. Among the various factors considered were the operations, properties, earnings and personnel of the Company and the market value of the Company's Common Stock, as well as judgments with regard to the prospects and future values of the Company. The Company's Board of Directors believes the transactions are advantageous to the Company's stockholders and has recommended adoption of the Merger Agreement and acceptance of the transactions contemplated thereby.

Arrangements with Employees of the Company

At the request of Unilever U.S. and pursuant to the terms of the Merger Agreement, the Company has entered into three year employment agreements (two years in the case of Messrs. Pascal and Thune) with the following officers of the Company: D.D. Pascal, C.G. Caldwell, S.F. Thune, S.A. Segal, H.R. Sampson, A.G. Battaglia, W.K. Grubman, N.G. Marotta, R.B. Albert, H.J. Baumgarten, R.A. Bintz, R.A. DeWolfe, F.L. Murphy and W.H. Stone. The contracts, which are effective upon consummation of the Merger, provide that each of the above employees will be paid a salary in such amount as shall from time to time be determined by or pursuant to authority granted by the Board of Directors of the Company, which amount shall not be at a rate less than such employee's current compensation. The contracts also provide that each employee will have the opportunity to earn cash

bonuses and receive other benefits on a basis consistent with the past practices of the Company.

Certain employees of the Company presently hold options to purchase shares of Company Common Stock and/or, in some cases, award units payable at a future time in Company Common Stock. The Company has entered into agreements with such employees providing for the cancellation of the options and award units outstanding at the Effective Time, effective upon consummation of the Merger. Under the agreements, each such employee will be paid on January 15, 1979, in consideration of such cancellation, an amount equal to the excess of $73.50 over the option exercise price per share multiplied by the number of shares covered by such employee's options (if any) outstanding at the Effective Time (whether or not such options are then exercisable), plus an amount equal to the excess of $73.50 over the base price of stock appreciation award units multiplied by the number of such employee's award units (if any) outstanding at the Effective Time. In addition, some of such employees and certain other employees hold shares of Company Common Stock ("Restricted Shares") previously granted which are restricted as to transfer and are subject to forfeiture for varying periods (see Note 9 to the Consolidated Financial Statements). The Company has waived the restrictions on transfer and provisions for forfeiture of Restricted Shares effective immediately prior to consummation of the Merger so that employees will receive $73.50 per share of Restricted Shares in the Merger. In addition, employees holding shares of Company Common Stock purchased in October or November, 1975, upon the exercise of qualified stock options will receive compensation for the loss of tax

benefits resulting from the disposition of such shares in the Merger.

The amounts so payable to employees will depend on the number of options and/or award units outstanding at the Effective Time (which in turn will depend on whether, prior to such Time, an employee exercises options or the number of options and award units is reduced by operation of their terms) and on whether employees dispose of shares for which they otherwise would have received amounts to compensate for loss of tax benefits. Based on present holdings, the amounts payable under the agreements (which do not include the $73.50 per share to be received by the holders of Restricted Shares) would be $850,057 in the case of the Company's officers and directors as a group (including $31,826 to Dr. Caldwell, $13,294 to Mr. Thune, $25,918 to Mr. Segal and $47,429 to Mr. Sampson), and $1,038,307 in the case of other employees.

Appraisal Rights of Dissenting Stockholders

Any holder of record of Company Common Stock has the right under Section 262 of the Delaware General Corporation Law to dissent from the Merger, to have his shares of Company Common Stock appraised by the Delaware Court of Chancery, and to receive the appraised value from the surviving corporation. Reference is made to Section 262, a copy of which is attached as Annex II to this Proxy Statement, for a complete statement of the appraisal rights of dissenting stockholders. The following information is qualified in its entirety by reference to Section 262.

In order for a holder of Company Common Stock to exercise his appraisal rights, he must satisfy all of the following conditions:

(1) Before the holders of Company Common Stock vote on the proposal to approve and adopt the Merger, the stockholder of record must deliver to the Company at 10 Finderne Avenue, Bridgewater, New Jersey 08807, *Attention*: Secretary, a written demand for the appraisal of his shares of the Company Common Stock. **This demand must:**

(a) Be made by the stockholder of record (or the duly authorized representative of the stockholder of record) and not by someone who is merely a beneficial owner of the shares (i.e., cannot be made by the beneficial owner if he does not own the shares of record);

(b) Identify the stockholder;

(c) State that the stockholder thereby demands the appraisal of his shares of Company Common Stock; and

(d) Be separate from and in addition to any proxy or vote against the merger.

Merely voting, or delivering a proxy directing a vote, against approval of the Merger will not satisfy this condition; a written demand for appraisal is essential. The written demand must be signed by the stockholder of record (or his duly authorized representative) exactly as his name appears on the form of proxy accompanying this Proxy Statement. A demand for appraisal of shares owned jointly by more than one person

must identify and be signed by all such holders. Any person signing a demand for appraisal on behalf of a partnership or corporation or in any other representative capacity (such as attorney-in-fact, executor,-administrator, trustee or guardian) must indicate his title and, if the Company so requests, must furnish proof of his capacity and his authority to sign the demand. Demands for appraisal should be sent to the Company (preferably by certified or registered mail, return receipt requested) at 10 Finderne Avenue, Bridgewater, New Jersey 08807, to the attention of the Secretary.

(2) The Stockholder must not vote in favor of the approval of the Merger, whether in person, by proxy or by written consent. A failure to vote will satisfy this condition, but a vote in favor of the approval of the Merger will constitute a waiver of the stockholder's right of appraisal and will, in effect, cancel his demand for appraisal. If a stockholder returns his proxy and does not vote against the Merger, and thereafter does not revoke his proxy, it will be voted FOR the Merger and the stockholder will be deemed to have waived his rights as a dissenting stockholder.

(3) Within 120 days after the effectiveness of the Merger, a stockholder of record must file a petition in the Delaware Court of Chancery demanding a determination of the value of the Company Common Stock held by all Company stockholders who have satisfied conditions (1) and (2) above, unless the surviving corporation or another stockholder will have filed such a petition within that period of time; provided that during

the first 60 days after the effectiveness of the Merger, a stockholder who has demanded appraisal has the right to withdraw such demand and accept payment of cash in the amount of $73.50 per share under the Merger Agreement. Within 10 days after the effectiveness of the Merger, the surviving corporation will notify each stockholder who has satisfied conditions (1) and (2) above of the date on which the Merger became effective. If neither the surviving corporation nor any stockholder of the Company files a petition for appraisal within 120 days after that date, the appraisal rights of Company Common Stock holders will cease, and they will only be entitled to receive cash in the amount of $73.50 per share in exchange for their respective shares of Company Common Stock. **At the present time, the Company's management expects that the surviving corporation will not file such a petition in the event a demand for appraisal is made. A final decision on that matter will be made if and when the occasion arises and will be based on the circumstances then existing.**

(4) If the Delaware Court of Chancery so requires, the stockholders of record must submit their Company Common Stock certificates to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings. If the Court invokes such a requirement and a stockholder fails to comply with it, the Court may dismiss the appraisal proceedings as to that stockholder, and he will lose his appraisal rights.

Since only holders of Company Common Stock of record may exercise appraisal rights, persons who beneficially own shares which are held of record by brokers, fiduciaries, nominees or others and who wish to exercise their appraisal rights must instruct the record holders of their shares to satisfy the conditions outlined above. If a stockholder of record does not satisfy within the time limits allowed all of the conditions outlined above, the appraisal rights for the shares of Company Common Stock held by him will be lost, and each of such shares will be converted into the right to receive cash in the amount of $73.50 per share on the effectiveness of the Merger, as provided in the Merger Agreement.

If the surviving corporation or any holder of Company Common Stock files a petition in accordance with condition (3) above, the Delaware Court of Chancery will hold a hearing on the petition, will determine the stockholders entitled to an appraisal and the fair value of the shares of Company Common Stock owned by such stockholders, exclusive of any element of value arising from the accomplishment or expectation of the Merger (such fair value could be determined to be more or less than the $73.50 per share payable in the Merger). The Court will then direct the surviving corporation to pay the appraised value of those shares, together with interest (if any), to the stockholders entitled thereto upon their surrender to the surviving corporation of the certificates representing such shares.

Upon the application of any party in interest, the Court will determine the amount of interest, if any, to be paid on the value of the Company Common Stock owned by the dissenting stockholders. In making its

determination with respect to interest, the Court may consider all relevant factors, including the rate of interest which the surviving corporation has paid for money it has borrowed, if any, during the pendency of the appraisal proceeding.

The costs of the appraisal proceeding may be determined by the Court and taxed to the parties in such manner as the Court deems equitable under the circumstances. Upon application of a dissenting stockholder, the Court may order all or a portion of the expenses incurred by any dissenting stockholder in connection with the appraisal proceeding (including, without limitation, reasonable attorneys' fees and the fees and expenses of experts) to be charged pro rata against the value of all shares of Company Common Stock entitled to an appraisal.

Any holder of Company Common Stock who demands his appraisal rights in accordance with condition (1) above will thereafter not be entitled to vote his Company Common Stock for any purpose after the vote on the Merger nor be entitled to receive any dividends or other distributions on such stock (except the special dividend described under "Dividend Record" below and any other dividends or distributions payable to stockholders of record as of a time prior to the effectiveness of the Merger) as long as his appraisal rights continue in existence. However, if such stockholder delivers to the surviving corporation an acceptance of the Merger and a written withdrawal of his appraisal demand within 60 days after the effectiveness of the Merger (or thereafter with the written approval of the surviving corporation), then such stockholder's right to an appraisal of his Company Common Stock will cease, and he will be entitled to

receive cash in the amount of $73.50 per share as a result of the Merger. No appraisal proceeding in the Court of Chancery, however, may be dismissed as to any Company stockholder without the approval of the Court, and the Court may condition any such approval on such terms as it deems just.

Expenses

The Merger Agreement provides that, whether or not the Merger and the Exchange Offer are consummated, the Company will pay its own expenses in connection therewith, and that Unilever U.S. will pay the expenses of Unilever U.S., Holding and Subsidiary in connection therewith. The Company estimates its portion of such expenses, assuming such transactions are consummated, to be approximately $2,800,000, including the fees and expenses of Morgan Stanley referred to under "The Proposed Merger—Investment Banking Opinion", above. Since the Exchange Offer prospectus is attached to this Proxy Statement, pursuant to the provisions of the Merger Agreement relating to expenses, Unilever U.S. will pay, or will reimburse the Company for, the portion of the mailing and other expenses of distributing the combined document (including any amount paid to brokers, dealers, banks and their nominees to reimburse them for expenses incurred in furnishing the combined document to their clients) which are attributable to the Exchange Offer prospectus.

Federal Income Taxes Consequences

The Company has received from the Internal Revenue Service a ruling (the "Ruling") dated June 28, 1978 to the following effect:

1. The Company, Subsidiary and Holding will recognize no gain or loss on the Merger.

2. Gain or loss will be realized and recognized by non-dissenting stockholders of the Company who do not accept the Exchange Offer upon the receipt by them from the Company in the Merger of cash in exchange for their Company Common Stock. The gain or loss of each such stockholder will be measured by the difference between the cash received by such stockholder in the Merger, and such stockholder's adjusted basis for the Company Common Stock surrendered in the Merger. Such gain or loss will be a capital gain or loss subject to the provisions and limitations of Subchapter P of Chapter 1 of the Internal Revenue Code of 1954, as amended (the "Code"), provided Section 341 of the Code (relating to collapsible corporations) is not applicable and the stock surrendered in the Merger qualifies as a capital asset in the hands of such stockholder.

3. If any stockholder of the Company dissents from the Merger and has his shares of Company Common Stock appraised under Delaware law, the cash received in payment of the appraised value

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*Special rules may apply in the case of shares acquired pursuant to the exercise of qualified stock options less than three years and one day prior to the Effective Time of the Merger or acquired pursuant to stock incentive awards and subject to restrictions on transfer which lapse immediately prior to the Merger.

of his shares will be treated as having been received as a distribution in redemption of his shares, subject to the provisions and limitations of Section 302 of the Code.

Based upon the Ruling, the Company is advised by its counsel, Messrs. Debevoise, Plimpton, Lyons & Gates, that the surrender by a stockholder of all of such stockholder's shares* of Company Common Stock for $73.50 per share in cash pursuant to the Merger Agreement will be treated as a taxable exchange with gain or loss being recognized, measured by the difference between the $73.50 per share received and the stockholder's cost or other tax basis in his Company Common Stock. Assuming that the Company Common Stock is a capital asset in the hands of a stockholder, the gain or loss recognized will be capital gain or loss, and if the stockholder has held such stock, or is deemed to have held such stock, for more than one year as of the Effective Time of the Merger, such gain or loss will constitute long-term capital gain or loss. The recognition of long-term capital gain by a stockholder may subject the stockholder to the 15% minimum tax imposed on tax preference items by the Code. In this regard, one-half of the net capital gain of an individual taxpayer is included as a tax preference item and a 15% minimum tax is imposed on such taxpayer's total tax preference items in any year to the extent such items exceed the greater of $10,000 ($5,000 in the case of married persons filing separately) or one-half of the regular income tax for the year (as defined). Such item of tax preference will also reduce the amount of the stockholder's income eligible for the 50% maximum rate of tax on personal service income provided by Section 1348 of the Code.

Messrs. Debevoise, Plimpton, Lyons & Gates have also advised that, based upon the Ruling, the receipt by dissenting stockholders of cash pursuant to appraisal proceedings under Delaware law will, in general, have the same tax consequences as described above for stockholders participating in the Merger except that the gain or loss being recognized, if any, will be measured by the difference between the appraised value received and the stockholder's cost or other tax basis in his Company Common Stock.

The above description of the Federal income tax consequences relates solely to receipt of $73.50 for each share of Company Common Stock, or the appraised value thereof, by a Company stockholder. Acceptance of the Exchange Offer by a stockholder with respect to such stockholder's shares of Company Common Stock will have the tax consequences described in the attached Exchange Offer prospectus under the heading "The Exchange Offer—Federal Income Tax Consequences".

It should be noted that various legislative proposals have been made which, if adopted, could affect the above description of Federal income tax consequences, including possible changes in the rate of tax imposed on capital gains and/or elimination of capital gains as an item of tax preference. Most of these proposals, as they are presently being considered, would not take effect until taxable years after 1978. The Company cannot predict the form, if any, legislation might take or the ultimate effective date of any such legislation.

It is recommended that stockholders consult their own tax advisors as to the extent of their Federal income tax liability as a result of the proposed trans-

actions and as to the tax consequences under any applicable local, state or foreign tax laws.

Agreement with the Principal Stockholders

Concurrently with the signing of the Merger Agreement, Anna A. and Frank K. Greenwall entered into an agreement with the Holding, dated as of March 16, 1978 (the "Letter Agreement"), a copy of which is attached hereto as Annex III, which provides that they will not, prior to the effectiveness of the Merger, permit shares of Company Common Stock beneficially owned by them to be sold, pledged or otherwise transferred or encumbered (other than by operation of law, upon death, by testamentary disposition or by exchange in the Exchange Offer), and will cause all such shares to be voted for and against the Merger at the Special Meeting of Stockholders in the same proportion as the vote of shares of all other stockholders voting upon the Merger. Mr. and Mrs. Greenwall beneficially own 944,436 shares of the Company Common Stock (approximately 14.4% of the outstanding shares). See "Principal Stockholders", below. Mr. and Mrs. Greenwall have advised the Company that it is their present intention to exchange all such shares for Holding Preferred Stock in the Exchange Offer, although a final decision on whether to accept the Exchange Offer will not be made until shortly before the expiration of the Exchange Offer and will be based on circumstances at that time.

Interest of Unilever Companies in Securities of the Company

Holding, Subsidiary, Unilever U.S., Unilever N.V. ("N.V."), Unilever Limited ("Limited") (see the Exchange Offer prospectus under "Unilever Group of Companies") and their majority-owned subsidiaries do not own, and will not acquire prior to the consummation of the Exchange Offer, any shares of Company Common Stock. To the best knowledge of Unilever U.S., no (i) executive officer or director of Holding, Subsidiary, Unilever U.S., N.V. or Limited or (ii) associate of Holding, Subsidiary, Unilever U.S., N.V., Limited or any executive officer or director thereof owns any shares of Company Common Stock. Neither Holding, Subsidiary, Unilever U.S., N.V., Limited nor any of their majority-owned subsidiaries has a right to acquire, directly or indirectly, any securities of the Company, except pursuant to the Merger Agreement and the Exchange Offer. To the best knowledge of Unilever U.S., no (i) executive officer or director of Holding, Subsidiary, Unilever U.S., N.V. or Limited or (ii) associate of Holding, Subsidiary, Unilever U.S., N.V., Limited or any executive officer or director thereof has a right to acquire, directly or indirectly, any securities of the Company.

Since May 1, 1978 neither Holding, Subsidiary, Unilever U.S., N.V., Limited nor any of their subsidiaries has effected any transaction in the Company Common Stock except pursuant to the Merger Agreement and the Exchange Offer. Since such date, to the best knowledge of Unilever U.S., no executive officer or director of Holding, Subsidiary, Unilever U.S., N.V., Limited or any associate of Holding, Subsidiary, Unilever U.S., N.V., Limited or any executive officer or director thereof or any executive officer or director of any subsidiary thereof has effected any transaction in Company Common Stock.

EXCHANGE OFFER

Attached to this Proxy Statement is an Exchange Offer prospectus by Holding. Under the Exchange Offer, all stockholders of the Company are being offered the alternative of exchanging their shares, at the Filing Time, for shares of a newly-issued non-voting preferred stock of Holding with a par value of $73.50 per share and a cumulative annual dividend of $3.31 per share (4.5% per annum). Each stockholder should carefully review the attached Exchange Offer prospectus for the terms of the Exchange Offer and related information, including the discussion of Federal income taxes and the desirability of consulting a tax advisor.

THE COMPANY AND ITS SUBSIDIARIES

National Starch and Chemical Corporation was incorporated in 1928 in Delaware under the name National Adhesives Corporation. The Company and its subsidiaries are engaged in the production of (i) adhesives and related products, (ii) starches and related products and (iii) specialty chemical products. Over the years the Company has placed continuing emphasis on research and development of products specifically designed for improved performance in particular applications, and on technical service to customers, most of which are industrial users.

CAPITALIZATION

The consolidated capitalization of the Company at March 31, 1978 is as follows:

	(Thousands of dollars)
Short-term debt (Note 1)	
Notes payable to U.S. and Canadian banks	$ 6,671
Notes payable—other	374
Long-term debt due within one year	2,427
Total short-term debt	9,472
Long-term debt (Note 2)	
Bank loan, on revolving credit basis at prime rates (8% at March 31, 1978), due March 1, 1980	12,000
Insurance company loan, 9⅞%, due 1980-1989	10,000
Other	2,695
Total long-term debt maturing after one year	24,695
Total debt	34,167

[1] See Note 6 of the notes to consolidated financial statements for information pertaining to short-term borrowings of the Company at December 31, 1977. Substantially all short-term borrowings are at interest rates of 8¾% at March 31, 1978.

[2] See Note 7 of the notes to consolidated financial statements for information pertaining to long-term debt at December 31, 1977. On May 23, 1978, the Company issued $18,000,000 aggregate principal amount of its 8.40% Notes due 1983-1993 to two insurance companies. A portion of the proceeds of such Notes ($12,500,000) were used to repay the then outstanding principal amount of the Company's bank loan due March 1, 1980, and the balance was used for general corporate purposes.

Shareholders' equity	
Preferred stock, no par; authorized 250,000 shares; none issued	
Common stock, $.50 par value; authorized 8,000,000 shares; 6,630,198 shares issued (Note 3)	3,315
Paid-in capital	45,508
Retained earnings	127,225
	176,048
Less common stock held in treasury— 66,268 shares	1,805
Total shareholders' equity	174,243
Total capitalization	$208,410

[3] Book value per share at March 31, 1978 was $26.55.

[4] See Note 9 of the notes to consolidated financial statements for information pertaining to employee stock option, stock incentive and stock purchase plans at December 31, 1977.

At March 31, 1978 there were 303,953 shares reserved for issuance under stock option, stock incentive and stock purchase plans.

[Exhibit 25-Y]

MORGAN STANLEY & CO.
INCORPORATED
1251 Avenue of the Americas
New York, N.Y. 10020

August 23, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08870

INVOICE

For financial advice rendered in connection with the acquisition of National Starch and Chemical Corporation by Unilever N.V.	$2,200,000.00
Out-of-pocket expenses	7,586.23
Fee and disbursements of counsel	18,000.00
Total	$2,225,586.23

CLIENT COPY

August 22, 1978

MORGAN STANLEY & CO. INCORPORATED

To: DAVIS POLK & WARDWELL
COUNSELLORS AT LAW
1 CHASE MANHATTAN PLAZA
NEW YORK, N.Y. 10005

For professional services to and incidental disbursements for Morgan Stanley & Co. Incorporated ("MS&Co.") as financial advisor to National Starch and Chemical Corporation (the "Company") in connection with the merger of the Company with a subsidiary of National Starch and Chemical Holding Corporation ("Holding"), a newly incorporated, indirectly wholly-owned subsidiary of Unilever N.V., and the related exchange offer to stockholders of the Company by Holding, including the following: advice as to the effect of the Federal margin securities regulations on the activities of MS&Co.; advice regarding the scope of and review of the investigation of the Company and the proposed transactions conducted by MS&Co.; review of minutes and various other corporate documents of the Company; review of and advice regarding opinion to be rendered by MS&Co. and form of supplemental opinion;

advice as to certain tax matters and alternative methods of structuring the transaction; review of and advice as to form of consent of MS&Co. to be included in the Registration Statement of Holding; and various conferences, telephone conferences, correspondence and legal research in connection with the foregoing $18,000.00

[Exhibit 26-Z]

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

March 8, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

To: Debevoise, Plimpton, Lyons & Gates, Dr.

FOR PROFESSIONAL SERVICES AND ADVICE rendered from October 1, 1977 through December 31, 1977, in connection with the proposed acquisition of your Company by Unilever United States, Inc.	$100,000.00
Received on account	15,000.00
	$ 85,000.00

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

April 6, 1978

Herbert J. Baumgarten, Esq.
Vice President and Counsel
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Herb:

Enclosed is our statement for fees for all matters other than Unilever, and for disbursements including Unilever, for the fourth quarter of 1977. As you may recall, our earlier statement for the Unilever work included a credit for the retainer.

I should also note that the lion share of the disbursements (over $3,000) is attributable to the Unilever work.

Please call if you have any questions.

Sincerely,

Edward A. Perell

Enclosure

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

April 6, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

To: Debevoise, Plimpton, Lyons & Gates, Dr.

FOR PROFESSIONAL SERVICES
AND ADVICE
rendered from October 1, 1977
through December 31, 1977 ..... $18,000.00

DISBURSEMENTS:

Overtime stenography and expenses incident to night and weekend work	$1,606.75	
Xerox and offset printing ...	1,023.25	
Telephone toll calls and telegraphic expenses	251.65	
Excess postage	30.57	
Lawyers' travel	338.05	
Messenger service and expense	273.60	3,523.87
		$21,523.87

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

May 10, 1978

Herbert J. Baumgarten, Esq.
Vice President and Counsel
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Herb:

Enclosed is our statement for fees and disbursements for the first quarter of 1978. As you can see, the Unilever portion is quite high, reflecting an extraordinary amount of work throughout the entire period.

Please call if you have any questions.

Sincerely,

Edward A. Perell

Enclosure

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

May 9, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

To: Debevoise, Plimpton, Lyons & Gates, Dr.

FOR PROFESSIONAL SERVICES AND ADVICE rendered from January 1, 1978 to March 31, 1978 ..... $197,000.00

Received on account 15,000.00

$182,000.00

DISBURSEMENTS:

Overtime stenography and expenses incident to night work	$4,145.15	
Xerox and offset reproduction	3,622.95	
Telephone toll calls and telegraph expenses	504.66	
Excess postage	9.36	
Messenger service and expense	414.10	
Lawyers' travel	516.52	
Miscellaneous	39.24	9,251.98

$191,251.98

May 9, 1978

NATIONAL STARCH AND CHEMICAL CORPORATION

Approximate Allocation of Fees
Among Items of Professional Service
January 1, 1978 through March 31, 1978

1.	General matters (review of agendas and minutes of meetings of Board of Directors and Consents of Executive Committee; advice with respect to various aspects of proposed acquisition; review of and advice with respect to Annual Report on Form 10-K; review of and advice with respect to Annual Report to Stockholders; preparation of letter to independent public accountants in connection with audit of financial statements; advice with respect to Annual Meeting of Stockholders and By-Law amendment; review of Registration Statement on Form S-8 — Stock Option and Stock Incentive Plans ...	$ 3,700.00
2.	Proposed acquisition by Unilever United States, Inc.	185,000.00
3.	Berkeley Heights property	5,500.00
4.	Private placement of 8.40% Notes ...	2,800.00
		$197,000.00

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

September 22, 1978

Herbert J. Baumgarten, Esq.
Vice President and Counsel
National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

Dear Herb:

Enclosed is our statement for fees and disbursements for the second quarter of 1978. If you have any questions about the statement, please give me a call.

Sincerely,

Edward A. Perell

Enclosure

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

September 12, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

To: Debevoise, Plimpton, Lyons & Gates, Dr.

FOR PROFESSIONAL SERVICES AND ADVICE rendered from April 1, 1978 to June 31, 1978		$124,000.00
Received on account		15,000.00
		$109,000.00
DISBURSEMENTS:		
Overtime stenography and expenses incidental to night work	$1,058.03	
Xerox and offset reproduction	1,898.45	
Telephone toll calls and telegraph expenses	493.63	
Excess postage	33.34	
Messenger service and expense	427.40	
Lawyers' travel	82.00	3,992.85
		$112,992.85

September 12, 1978

NATIONAL STARCH AND CHEMICAL CORPORATION

Approximate Allocation of Fees
Among Items of Professional Service
April 1, 1978 through June 30, 1978

1.	General matters (including review of agendas and minutes of meetings of Board of Directors and Consents of Executive Committee; advice with respect to various aspects of proposed acquisition; preparation of and advice with respect to Part II of Annual Report on Form 10-K; review of and advice concerning quarterly report on Form 10-Q; advice with respect to Iranian investment; advice with respect to U.S. laws and regulations relating to Arab boycott; advice from time to time to the Company's officers concerning the foregoing and related matters	$ 5,000.00
2.	Acquisition by Unilever United States, Inc.	105,000.00
3.	Registration Statement on Form S-8 — Stock Option and Stock Incentive Plans	4,500.00
4.	Berkeley Heights property	1,000.00
5.	Private placement of 8.40% Notes ..	8,500.00
		$124,000.00

DEBEVOISE, PLIMPTON, LYONS & GATES
299 PARK AVENUE NEW YORK, N.Y. 10017

October 19, 1978

National Starch and Chemical Corporation
10 Finderne Avenue
Bridgewater, New Jersey 08807

To: Debevoise, Plimpton, Lyons & Gates, Dr.

FOR PROFESSIONAL SERVICES AND ADVICE
rendered from July 1, 1978 to September 30, 1978 ..... $118,000.00

Received on account 15,000.00

$103,000.00

DISBURSEMENTS:

Overtime stenography and expenses incidental to night and weekend work	$1,075.65	
Xerox and offset reproduction .	857.60	
Telephone toll calls and telegraph expenses	465.46	
Excess postage and Air Freight .	90.42	
Messenger service and expense .	253.20	
Lawyers' travel	550.23	
Mescellaneous:		
United States Corporation Company for good standing certificates from various States	731.70	4,024.26
		$107,024.26

October 19, 1978

NATIONAL STARCH AND CHEMICAL CORPORATION

Approximate Allocation of Fees
Among Items of Professional Service
July 1, 1978 through September 30, 1978

1.	General matters (review of agendas and minutes of meetings of Board of Directors and stockholders and consents of Executive Committee; review of and advice concerning quarterly report on Form 10-Q; advice with respect to disposition of Berkeley Heights property; advice with respect to exemption from regular reporting requirements of Securities and Exchange Act of 1934; advice with respect to possible licensing arrangements with another company; review of litigation papers involving Permabond International Corporation; and advice from time to time to the Company's officers concerning the foregoing and related matters)	$ 4,000.00
2.	Acquisition by Unilever United States, Inc.	100,000.00
3.	Advice with respect to and preparation of new executive incentive plan ..	8,500.00
4.	Advice with respect to proposed acquisition ("Dynamite")	5,500.00
		$118,000.00

[Exhibit M]

December 22, 1977

Ms. Mary H. Weiss
Division of Enforcement
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

National Starch and Chemical Corporation

Dear Ms. Weiss:

At your request, enclosed is a Chronology of Events (through December 2, 1977) relating to the proposed acquisition of National Starch and Chemical Corporation by Unilever United States, Inc. The Chronology is based on the recollections of Messrs. Greenwall and Pascal at National Starch and Messrs. Ruebhausen, Perell and myself at Debevoise. If you have any questions about the Chronology, please feel free to call either Mr. Perell or me.

Very truly yours,

/s/ KLW

Kenneth L. Wallach

Enclosure

KLW:mra
NSC-Unilever 01302-600

CONFIDENTIAL
FOR USE OF PERSONNEL OF
NEW YORK STOCK EXCHANGE
AND SECURITIES AND EXCHANGE
COMMISSION ONLY

NATIONAL STARCH AND CHEMICAL CORPORATION

Chronology of Events through 12/2/77

Date	***Event***
10/7/77	Felix Rohatyn, a partner of Lazard Freres & Co. ("LF"), met, at Mr. Rohatyn's request, with Frank K. Greenwall, Chairman of the Executive Committee of National Starch and Chemical Corporation ("NSC"), and Donald D. Pascal, Chairman of the Board of NSC, and indicated that Unilever N.V. was looking at a number of U.S. companies, including NSC, with the possibility of acquisition in mind. This was the first time that either Mr. Greenwall or Mr. Pascal were aware of such an interest. Mr. Rohatyn asked whether Mr. Greenwall would be willing to discuss the possibility of a cash sale of NSC shares by Mr. Greenwall and his wife Anna A. Greenwall, to Unilever, as part of an acquisition of all NSC shares by Unilever. Mr. Rohatyn indicated that Unilever was not thinking of an "unfriendly"

	tender situation and would proceed with discussions only if the Greenwalls were willing to sell their shares, and in that event, then only if the Company favored the acquisition. Mr. Greenwall told Mr. Rohatyn that he would give the question some thought.
10/11/77	Mr. Greenwall met with Oscar M. Ruebhausen, a partner of Debevoise, Plimpton, Lyons & Gates ("DPL&G"), counsel to Mr. and Mrs. Greenwall and NSC, and informed Mr. Ruebhausen of Mr. Rohatyn's inquiry. After the meeting, Mr. Ruebhausen informed Edward A. Perell, a DPL&G partner responsible for NSC matters, of the meetings.
10/13/77	Mr. Pascal informed Carlyle Caldwell, President of NSC, of Mr. Rohatyn's discussion with Mr. Greenwall and himself.
10/17/77	Messrs. Ruebhausen, Perell, Greenwall and Pascal met to discuss various legal questions.
10/18/77	Messrs. Perell and Ruebhausen discussed the tax and estate planning considerations with Philip S. Winterer, another partner in DPL&G. Additional DPL&G lawyers were consulted on various legal

questions without disclosure of the names of the persons involved.

Mr. Greenwall called Mr. Rohatyn and informed him that an all cash transaction would not be attractive to Mr. Greenwall because of his estate planning considerations, but that he was speaking only as an individual in response to a question put to him.

10/19/77 — Messrs. Rohatyn, Greenwall and Ruebhausen met to discuss the legal and other problems involved in structuring a transaction so that, among other things, an opportunity for a tax-free exchange would be available to all shareholders.

10/20/77 — Messrs. Greenwall, Pascal, Ruebhausen, Perell and Rohatyn met for further discussion of the structural issues and the importance of having them clarified prior to any substantive discussions. The priority that should be given to structural analysis was accepted by all and Mr. Rohatyn suggested that the next step might profitably be a meeting of Unilever's counsel with NSC's counsel. It was understood that a decision by Mr. Greenwall as to whether or not he wished to sell his shares would be deferred pending the outcome of the discussions among lawyers as to a workable

structure. A meeting was then scheduled for the next day between DPL&G and Unilever's counsel, Cravath, Swaine & Moore ("CS&M").

A DPL&G associate, Kenneth L. Wallach, was advised of the identity of the persons involved and the status of the discussions.

10/21/77 — A meeting took place between DPL&G (Messrs. Ruebhausen, Perell, Winterer, Wallach, Meredith Brown* and Craig Friedrich) and CS&M (Messrs. George Tyler, James Edwards and Miles Fischer), at which Donald J. Lunghino, counsel for Unilever United States, was present, and at which CS&M described possible alternative structures.

An additional DPL&G associate, Paula Harbison, was advised of the parties involved in the discussions.

10/26/77 — A meeting took place between DPL&G (Messrs. Perell, Brown,

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*Mr. Brown, a DPL&G partner, had been informed of the persons involved and the status of the discussions earlier on 10/21/77.

Wallach and Friedrich**), CS&M (Messrs. Tyler, Edwards and Fischer) and Mr. Lunghino, at which problems in arriving at structure were discussed.

10/27/77 — Mr. Greenwall and Mr. Perell each telephoned John Muldowney, Mr. and Mrs. Greenwall's personal accountant, and requested that he prepare figures showing tax consequences of cash and tax free transactions.

Mr. Greenwall spoke to Mr. Rohatyn about uncertainties of structure and was advised by Mr. Rohatyn that Unilever did not intend to force the acquisition if Mr. Greenwall or NSC did not wish to enter into discussions.

10/28/77 — A conference was held to further discuss possible structure. Present were Messrs. Greenwall and Pascal, Messrs. Rohatyn and Peter Jaquith (partner of LF), Messrs. Perell and Winterer (DPL&G), Mr. Edwards (CS&M) and Mr. Lunghino.

11/3/77 — A conference was held in Washington at IRS to explore possible tax structure, without disclosure to IRS of names of parties. In addition to IRS

**Mr. Friedrich, a DPL&G associate, did not become aware of the persons involved until the meeting on 10/26/77.

personnel, present were Winterer, Friedrich and Henry DeKosmian (partner of CS&M).

11/7/77 — After the regular meeting of the NSC Board of Directors, at which all directors were present other than Mr. Ruebhausen, the NSC directors were informed of the inquiry on behalf of Unilever and the structural investigations and discussions under way. The Board was advised that no further steps on a decision as to whether discussions on a possible acquisition would take place unless a structure could be worked out. It was decided that if it appeared that a structure was possible, there would be no negotiations or decision on terms without advice from an independent investment banking firm. Mr. Perell was the only nondirector present.

11/9/77 — Messrs. Friedrich and Winterer spoke with IRS personnel concerning the 11/3/77 conference and advised Mr. DeKosmian of this conversation.

11/10/77 — A conference was held among Messrs. Perell, Wallach, Lunghino, Edwards and Jaquith, at which the parties were advised by Mr. Perell that NSC intended to engage an investment banking firm to review the situation and to advise NSC as to

	whether NSC should enter into discussions with Unilever.
11/11/77	After a meeting with Messrs. Pascal, Ruebhausen and Perell, Mr. Greenwall called Mr. Robert Baldwin, President of Morgan Stanley & Co., Inc. ("MS"), requesting a conference on 11/14/77. The purpose of the conference was not discussed.
11/14/77	Messrs. Greenwall, Pascal, Ruebhausen and Perell met with Mr. Baldwin, informed him of the inquiry from Mr. Rohatyn and of the discussions with Unilever's counsel and engaged MS to advise NSC as to appropriate courses of action for NSC.
11/15/77	A conference took place among Messrs. Perell, Brown and Wallach (DPL&G) and Robert Greenhill, R. Bradford Evans and Dennis R. Haydon (MS), at which the details of discussions with Unilever's counsel and LF were described.
11/17/77-12/2/77	A number of conferences were held among DPL&G and MS personnel to discuss NSC's operations and possible structures for a Unilever transaction. Also discussed were general thoughts about other companies as possible merger partners. In addition, representatives of MS met with Messrs. Caldwell and S. A. Segal

	(Senior Vice President and a Director of NSC) on 11/19/77 to discuss NSC's operations. It is believed that MS had several conferences with LF to explore further possible alternative structures which might form the basis for negotiations.
11/28/77	An additional DPL&G partner, Andrew C. Hartzell, and an additional DPL&G associate, Roger Podesta, were advised of the discussions. Mr. Hartzell spoke to Richard Wertheimer, a partner of Arnold & Porter, antitrust counsel to Unilever, about the discussions and scheduled a meeting for the afternoon of 11/30/77.
Early in week of 11/28/77	A dinner meeting was scheduled for Friday evening, 12/2/77, at which principal officers of NSC and of Unilever would meet for the first time to discuss the operations of the two companies and general philosophy of how NSC would be run if a combination took place; no negotiations were to take place.
11/30/77	A conference took place at DPL&G among Messrs. Hartzell, Podesta and Wertheimer to discuss antitrust aspects of a possible combination of companies.
12/1/77	Mr. Perell, on behalf of NSC, asked NSC's listing representative at the

New York Stock Exchange to halt trading of NSC stock at approximately 11:00 A.M. A press release was issued shortly thereafter.

UNITED STATES TAX COURT

(Caption omitted in printing)

SUPPLEMENTAL STIPULATION OF FACTS

(Filed June 16, 1987)

The below signed parties hereby agree to this Supplemental Stipulation of Facts pursuant to the same terms and conditions as set forth in the Preamble of the original Stipulation of Facts dated June 4, 1987:

1. Petitioner's Form 1120 return for the 1978 fiscal year was filed on September 14, 1979, and reported a tax liability of $5,802,017.

2. Petitioner made estimated tax payments with respect to the 1978 fiscal year on the following dates in the amounts shown:

Date	Amount
April 17, 1978	$850,000
April 17, 1978	2,000,000
June 15, 1978	2,500,000
September 15, 1978	840,000
September 15, 1978	360,000
	$6,550,000

3. On October 11, 1979, Petitioner received a refund of $747,983 from Respondent.

4. The statute of limitations for assessment of tax with respect to the 1978 fiscal year was extended, pursuant to Section 6501(c)(4) of the Internal Revenue

Code, by agreements in writing executed by Petitioner and Respondent as follows:

Date Signed by Petitioner	Date Signed by Respondent	Statute Extended Until
June 18, 1982	June 23, 1982	June 30, 1983
February 2, 1983	February 10, 1983	December 31, 1983
June 24, 1983	June 15, 1983	June 30, 1983

5. Pursuant to a partial agreement executed by Petitioner and Respondent involving unrelated issues, Petitioner paid $257,444 on September 20, 1983, as an additional tax assessment with respect to the 1978 fiscal year.

6. The DPL&G fee of $490,000 (plus out-of-pocket expenses of $15,069) charged Petitioner was determined by allocating the total cost of the services rendered by DPL&G between Petitioner and the Greenwalls in the proportion two-thirds to Petitioner and one-third to the Greenwalls for the period October 11, 1977 through December 31, 1977. For the period January 1, 1978 through August 15, 1978, the services of DPL&G were separately accounted for as between Petitioner and the Greenwalls. The total DPL&G fee was reasonable in amount and was determined at arm's length in accordance with DPL&G's normal billing practices. Respondent does not stipulate that the allocation of the DPL&G fee between Petitioner and the Greenwalls reflects the services rendered to each.

7. Copies of the following documents prepared by (or in the case of exhibits R and V, from the files of) DPL&G are attached as exhibits as indicated.

Description	Exhibit
–10/20/77 Memo re: Acquisition Structuring	P
–10/24/77 Memo re: Alternative Structure	Q
–10/26/77 Letter from CS&M to DPL&G (with enclosure)	R
–10/21/77 Draft "Agreements in Principle"	S
–Undated Draft "Agreements in Principle"	T
–11/1/77 Memo re: latest Draft (10/31/77) "Memorandum of Terms"	U
–11/17/77 letter from CS&M to DPL&G (with enclosure)	V
–11/18/77 Memo re: Summary of Delaware and New Jersey Takeover Statutes	W
–12/2/77 Letter from DPL&G to Morgan Stanley (with enclosure)	X
–12/4/77 Draft "Memorandum of Terms"	Y
–12/6/77 Memo re: Comments on Proposed Memorandum of Terms	Z
–12/9/77 Draft "Letter of Intent"	AA

–2/28/78 Memo re: Summary of DPL&G Due Diligence Activities — AB

–March 1978 Memo re: DPL&G Due Diligence–Thomas J. Lipton, Inc. and Lever Brothers — AC

–2/1/78 DPL&G letter re: draft agreement concerning payment of tax liabilities of Holding — AD

–3/10/78 Memo re: Restrictions on the Transfer of Securities to Designated Persons Under Delaware law — AE

–2/27/78 Memo re: Voting Agreements — AF

–11/9/77 Memo re: Directors & Officers Liability Insurance — AG

Petitioner stipulates only that these documents are authentic copies of items prepared by or from the files of DPL&G, as the case may be, but does not stipulate

as to the truth of the contents thereof and reserves all other evidentiary objections.

WILLIAM F. NELSON
Chief Counsel
Internal Revenue Service

/s/ Leonard E. Kust
Leonard E. Kust

By: /s/ Richard J. Spinski
Richard J. Spinski
International Special Trial Attorney

CADWALADER, WICKERSHAM & TAFT
100 Maiden Lane
New York, New York 10038
(212) 504-6000

600 Arch St.,
Room 10424
Philadelphia, Pa. 19106

June 15, 1987

Transcript of Trial before Judge Charles E. Clapp, II, United States Tax Court

(p. 21) Whereupon,

NED W. BANDLER

was called as a witness and, having been first duly sworn, was examined and testified as follows:

THE CLERK: Please be seated and state your name and address for the record.

THE WITNESS: Ned W. Bandler, 322 Central Park West, New York 10025.

DIRECT EXAMINATION

BY MR. WALKER:

Q. Good morning, Mr. Bandler.

Would you please state your present occupation for the Court?

A. I'm senior vice president and a director of Unilever United States and director and officer of a number of smaller subsidiaries of Unilever U.S.

Q. What are your current responsibilities as senior vice president of Unilever United States?

A. My principal duties are acquisitions and divestitures or the corporate development portfolios, as it's normally described.

I'm responsible for the administration of the holding company and for external affairs for Unilever United States.

(p. 22) Q. Could you summarize your prior employment?

A. Following graduation from college, I worked for six years for a foods and dairy products manufacturing company which later became a subsidiary of Foremost Dairies.

I joined Lever Brothers in 1956 in their sales and marketing division, and moved into corporate development work as a corporate developer and analyst in '57 and corporate development manager some years thereafter, and became director of corporate development for Lever Brothers Company in 1964.

In 1976 I was seconded to the staff of the Unilever corporate development director where I worked exclusively on the North American acquisition project that led to the acquisition of National Starch in 1978.

In 1978 I became a vice president for administration and planning and corporate development for the newly created Unilever United States and in 1983 I became senior vice president and director of Unilever United States.

Q. Would you describe briefly the organization of Unilever and its subsidiaries?

A. Unilever is an international business, somewhat unusual in structure because there are two Unilever companies — Unilever PLC based in London and Unilever NV based in the Netherlands. They
(p. 23) have identical boards of directors although they are two discrete, independently organized corporations.

Unilever United States is a wholly owned subsidiary of Unilever NV, and Unilever United States in turn is the holding company which owns all the shares of Lever Brothers Company, Thomas J. Lipton, Na-

tional Starch and Chemical and Chesebrough-Ponds, plus a number of minor subsidiaries.

Q. You stated earlier in your testimony that you had been involved in a North American acquisition project I believe beginning in 1976.

Could you describe what that project was?

A. For many years Unilever had been unsuccessful in expanding its relatively modest base in the United States and they had tried a number of ways to acquire businesses and expand to a reasonable percentage of their total business. These had not been successful.

In 1976, the Unilever corporate development director, whom I may refer to afterwards, a Mr. Henk Meij M-e-i-j — was a main board member of Unilever NV and Unilever PLC, was asked to try to find a new way to succeed.

He decided that he could not do that unless he spent considerable time in the U.S. and had a U.S. staff of his own.

(p. 24) I was, although an employee of Lever Brothers, seconded to his staff in June of 1976. We had an 18-month mandate from the board and executives of Unilever to make a thorough analysis of acquisition opportunities in the U.S., review Unilever's overall strategy, and to make recommendations of suitable acquisition candidates.

Q. Mr. Bandler, I would appreciate it if you would describe briefly the activities which took place over this 18-month period.

A. Beginning with Mr. Meij's organization of the project, which was approved by the board of Unilever, my small staff in New York and his small staff in Europe arranged to work together to do an overall comprehensive analysis of Unilever's current position in various industrial areas and an assessment of our strengths and weaknesses and to identify those areas that it was plausible to look.

In order to accomplish this, Mr. Meij and I agreed that I would spend a full week in Europe every other month and he would spend a full week in the United States and that our staffs would work together in a very intensive way to do this job in a relatively compressed period of time.

Because Unilever is a complicated organization with approximately 20 main board directors, each of whom have responsibilities in different areas, such as
(p. 25) edible fats and dairy products, foods, detergents, personal products, we also spent a great deal of time meeting with each of the Unilever directors to make sure that we had the fullest support for any acquisition that was identified.

We then began what could only be described as a grueling and intensive examination of 700 businesses that had been identified in the U.S. as meeting certain of the criteria that we had initially set, which would include growth potential, a strong management, meeting financial criteria we had set and falling within the range of scale of investment that we believed would be appropriate.

Within a relatively short period of time, that list of 700 was condensed to a list of 100, and thereupon, after a series of meetings with all of the relevant

Unilever directors who had industrial interests in one area or another, the list was further winnowed down then to 30 and then to a more manageable list which was reviewed over a period of months in greater detail with the special committee.

I should just add that the special committee of Unilever is a three-man executive consisting of the chairman of NV, the chairman of PLC, and a third member who functioned in the conventional way that a U.S president or CEO would function.

Q. Did there come a time when Unilever reached
(p. 26) a decision concerning an acquisition candidate?

A. Yes. We had cast a very wide net for several reasons, not the least of which was that one could not be sure as to whether or not a management was receptive to acquisition talks.

If a business presented what appeared to be serious antitrust problems, you had to give further consideration as to whether it should be included.

We did not narrow on a precise candidate, but had picked a number of businesses which varied widely in terms of their relationship to our existing businesses but which had several common characteristics, and this list was narrowed in meetings with the special committee based on the recommendations that we made.

Q. Was one of the candidates who was selected National Starch and Chemical Corporation?

A. National Starch and Chemical was one of a number of semifinalists which then led us to do more intensive studies in which we brought in outside experts to study each business we had picked.

For example, McKinsey and Company studied one of the businesses in the semifinals who is Alan Hamilton, Monton Rumsey and Charles Klein, so we supplemented our work at that point with very intensive
(p. 27) analyses of the businesses and the categories in which these businesses were placed.

Q. What were the factors which led Unilever to select National Starch and Chemical?

A. As we narrowed the list down, we were very much impressed with the fact that National Starch met many of the principal criteria which was an excellent growth record, potential for development in the future, a management that had demonstrated enormous strength and versatility, people of the highest reputation and thus people we would be proud to be associated with.

The size of the business was well within the financial range that our people had said was permissible. Our opportunity to carry the acquisition through seemed to a good prospect, and of all the companies we were then considering this seemed to be one that we should approach first.

Q. Was consideration given as to whether or not the combination of National Starch and Unilever would result in any synergy for National Starch?

A. That was, if you reflect on it, a political problem within Unilever because naturally after so many years of not being successful in the U.S., our people would have been delighted to have a company with enormous synergy.

(p. 28) To buy a business that fit into one of our consumer products lines would have been ideal but that also was a problem of limited availability and also the potential of antitrust problems and so many of those desirable candidates fell away.

National Starch did not present an opportunity for synergy in the classic sense but it was not a business that was alien to Unilever's activities. It was a good supplement and a third leg of substance for Unilever in the United States.

We did not have, however, synergy in the sense that what we could put to the business would necessarily enhance the business or vice versa.

Q. After selection of National Starch as a potential candidate, what steps took place? What happened next?

A. As part of our 18-month mission in this project, not only to make the industrial cases for businesses and to identify candidates, but to recommend to Unilever a strategy of approach.

As an example of how we went at that, Mr. Meij and I made the rounds of prominent investment bankers in New York to see where investment bankers could be useful.

We also had direct contact with some of the companies on the list so we approached each one on an
(p. 29) individua1 basis in an attempt to determine what was the most promising and sensitive way to make that contact.

Q. What approach was decided upon for National Starch?

A. We concluded after an analysis of all the relationships that may have existed within the company with people in National Starch that we should in the first instance approach them through an investment bank.

The logic of this approach is if an intermediary is rebuffed, you still can have one of your top people do it. If one of your top people is rebuffed, you often have nowhere to go.

Q. Who was selected to make the approach?

A. Lazard Freres had been our bankers on a number of matters over years and we had concluded that they would be the best emissary in this and so we asked Mr. Felix Rohaytn to make the initial contact with National Starch.

Q. Did Lazard Freres play any role in identifying National Starch as a potential acquisition candidate?

A. No. We did not feel that we needed to bring investment bankers into the process of analyzing what Unilever's objectives ought to be or what would best meet those needs.

This initial impression was supported by our management for several reasons. First of all, the
(p. 30) maintenance of confidentiality is extremely difficult even when you have a small group within your own business. The minute you add outsiders and the commotion that attends such activity, you cut your chances further so all of this work was done by internal people.

We did consult periodically with investment bankers primarily for a sense of the industrial correctness of some of our assumptions and to build what you

would call the basic commercial intelligence to support an acquisition.

Q. What instructions were given to Lazard Freres in terms of making an approach to National Starch?

A. The key to our strategy of approach was first to determine receptivity, since it was Unilever's preference and we felt Unilever's interests would be best served by a negotiated transaction rather than one that had any element of management reluctance.

Q. Did Lazard make an approach to National Starch?

A. They did and National Starch's response was appropriate I think for any publicly owned business, that they obviously would consider an offer, a responsible offer, and I think the — my recollection is that there was some request on their part that we come up with a specific figure before they could consider it seriously.

Q. Did there come a time when in fact an agree-
(p. 31) ment in principle was reached between National Starch and Unilever with respect to the acquisition of National Starch by Unilever?

A. Yes. Following that initial approach, our two chairmen came over, there were discussions and on December 11 of 1977 we entered into a letter of intent with National Starch which was subject to securing a tax ruling with respect to the nature of the transaction for which we filed immediately.

Q. Mr. Bandler, did you have substantial involvement in the acquisition following the signing of the letter of intent?

A. At that point this became a principal endeavor for tax specialists, for the various attorneys representing all of us to carry out the terms of that letter of intent, so my own role at that point had been reasonably concluded.

MR. WALKER: Thank you, Mr. Bandler. I don't have any further questions at this time.

THE COURT: Mr. Sapinski, do you wish to examine?

MR. SAPINSKI: Yes, Your Honor.

CROSS-EXAMINATION

BY MR. SAPINSKI:

Q. Mr. Bandler, you testified that Lazard Freres did not play a role in identifying National Starch as a
(p. 32) candidate.

We stipulated Lazard did receive approximately $2,400,000. Will you tell us what that fee was paid for?

MR. WALKER: Objection. If this witness is qualified to answer what Lazard was paid — I doubt that.

MR. SAPINSKI: Your Honor, he testified he was the director of corporate development, and he was one of the supervisors of this project and he was dealing with those people. I think he's competent to answer the question.

THE COURT: I think if Mr. Bandler knows anything about what Lazard Freres was paid for, he can say so. If he doesn't, I'm sure he can say he doesn't know.

THE WITNESS: The ways of investment bankers is something that I have to leave to those who are perhaps investment bankers themselves.

The fees that are charged by investment bankers are negotiated and in this case the financial director of Unilever, who had multiple involvements with Lazard and with Mr. Rohatyn, obviously had to arrive at a fee that they regarded as satisfactory.

This was not a role in which the American corporate development group had any say, but I think you can conclude that somebody of Mr. Rohatyn's stature who did perform those tasks which Unilever set for
(p. 33) him in this had arrived at a way of satisfying Unilever that those services were indeed worth what they paid for them.

BY MR. SAPINSKI:

Q. What tasks were those?

A. Well, the approach to National Starch was made by Mr. Rohaytn and he then — he did participate in a number of meetings with Unilever's management.

I could make the case based on my own experience that this is a very critical period in the development of an acquisition and if in the end the mix of Lazard's advice to Unilever and Unilever's response to that advice was wrong, we might not have had a transaction.

Those meetings which were attended by David Orr, the chairman of the PLC, Franz VandenHoven, the chairman of NV and various other directors took place both in New York and there was another meeting at Heathrow Airport in which I know there were ex-

tensive discussions of how much one did and how one did it.

I think in summary Unilever must have been satisfied in arriving at that fee.

I, as the director of corporate development, while I played I hope a very constructive role in that, I was not an officer of the company and certainly not privy to an analysis of even how much the lawyers got paid.

(p. 34) Q. Do you know whether part of what Lazard was paid for included advice as to how much they should pay for National Starch?

A. Well, it would be inconceivable that you sat down with an investment banker and did not try to get a view as to what they thought the market price was for a business of that sort, what they thought of the potential, how they saw the industry.

It is not a snapshot sort of process. You talk with people, you form opinions, you draw on the talents of diverse people, and it would be very difficult for me to say that there is any one single person whose omissions made possible shortcutting this very sustained and at time very enervating process of arriving at a consensus.

Q. Not to put words in your mouth, but I understand your answer to mean that it's inconceivable to you that they didn't at least participate.

A. Participate in advising?

Q. Right.

A. The question whether their advice was the final figure that came out, I would say that when you

go into an acquisition what you find out is everybody's perception is apt not to stand the view of history.

I think some of us took views of what the price
(p. 35) should be that were not realistic in the end.

Q. Do you know if Lazard rendered any sort of a fairness opinion to Unilever shareholders?

A. My impression—I never saw such an opinion but since we are a public company and we had to vouch for the appropriateness of the transaction, my assumption is that that is so.

Q. But you don't know.

A. I never saw the opinion but I assume we had one of that type.

Q. You mentioned before that the letter of intent was subject to a tax ruling. Could you explain why there had to be a tax ruling?

A. Yes The Unilever NV, while a publicly listed company with shares, had some complications with using them. Our shares were selling at an extraordinarily low multiple. Because it was a foreign owned business, people did not understand the shares so we did not have the flexibility that other companies had in using our own shares, so we were seeking a cash transaction.

The problem with a cash transaction for some shareholders is that they could not defer their capital gain and National Starch had two groups of shareholders—some with a very low base and some
(p. 36) who were people who had bought it recently on the open market.

Throughout the discussions we had with National Starch, we were impressed by the sense of fairness of the management who felt that they could not accept any sort of deal that did not treat all shareholders equally, but they did not feel it fair to those with a low base to have to take cash and pay the capital gains if there was another option.

We felt that there was a way that we could create an acquisition transaction whereby those who wished to accept a special class of preferred stock—I think it was 4-1/2 percent preferred—could opt for that and those who wanted cash could receive cash.

We went to the Internal Revenue Service to seek a ruling and such was our confidence in this approach that we were able to reach a letter of intent based on the expectation that the Internal Revenue Service would provide such a ruling, which they did.

Q. I understand that.

Mr. Bandler, the original approach, I believe you testified, was to Mr. Greenwall. From Unilever's point of view, as I understood you to say, you wanted if possible a cash transaction, and if I understood you also, the preferred was something to make the trans-
(p. 37) action palatable to certain shareholders of National Starch.

Would it be fair to say that Unilever wanted to pay as close to cash as possible in the transaction?

A. I should mention one thing. It is my recollection that the first approach by Mr. Rohaytn was to Dr. Carlisle Caldwell, who was the president of National Starch, not to Mr. Greenwall, but that I do not know of my own knowledge.

Q. We stipulated it was to Mr. Greenwall.

A. When I refreshed my recollection, I did find that there had been a discussion with Dr. Caldwell and Mr. Rohaytn.

In any case, given Mr. Greenwall's role in the company, he would have been fully involved at the beginning.

Q. Let me ask you this. At any point did Unilever give consideration to making a hostile takeover bid for National Starch?

A. Certainly within those who had the professional responsibility for this project—Mr. Meij and myself and others—we regarded such an event as utterly inconceivable because it's a matter of industrial common sense.

[illegible] make a hostile tender offer for a company wh[illegible] very different from your own, which does not fit in[illegible] our own corporate structure, which you would have no way of managing after you bought it because
(p. 38) you have no people who understand the starch or adhesives or other specialty chemicals that they manufacture. It would make no sense to do that.

Whether it was considered, I would say in the course of an acquisition project it is possible that somebody may have thought of the idea but they must have put it out of their minds very quickly.

Q. So it was to be a friendly deal or no deal.

A. Our interest was in a negotiated deal where the hearts and minds of the executives and the employees went with the transaction. We could not afford to have any other kind of deal.

MR. SAPINSKI: Thank you, Mr. Bandler. I have no more questions.

MR. WALKER: I have no further questions.

THE COURT: Thank you very much, Mr. Bandler. I appreciate your coming down to help us out.

(Witness excused.)

MR. WALKER: Your Honor, our second witness is Mr. Perell, who is a partner in the firm of Debevoise and Plimpton. I'll get him from the witness room.

(Recess.)

(p. 39) Whereupon,

EDWARD A. PERELL

was called as a witness and, having been first duly sworn, was examined and testified as follows:

THE CLERK: Please be seated and state your name and address for the record.

THE WITNESS: My name is Edward Andrew Perell and my residence address is Cricket Lane, Dobbs Ferry, New York.

MR. WALKER: Your Honor, before proceeding with my examination of Mr. Perell, may I introduce the Court to Mr. Daniel Murphy who is also a partner at Debevoise and Plimpton, who has been representing Mr. Perell in terms of our discussions with Mr. Perell and the government's discussions before trial.

There is one issue that is a bit sensitive and I would request the Court's permission to permit Mr. Murphy to sit within the well of the court for

purposes of guarding an attorney-client privilege for Mr. Greenwall, who was the principal shareholder of National Starch.

Debevoise performed services for Mr. Greenwall as well as for National Starch. Mr. Greenwall is now deceased and it's our understanding that the attorney-client privilege cannot be waived at this point and we
(p. 40) would request permission to have Mr. Murphy present during the questioning of Mr. Perell simply to make sure that no one gets off bounds and asks questions which would be objectionable in that sense.

THE COURT: What's he going to do—wave a red flag or something like—or maybe it's a checkered flag. All right.

DIRECT EXAMINATION

BY MR. WALKER:

Q. Mr. Perell, what is your occupation?

A. I'm an attorney.

Q Are you affiliated with a firm?

A. Yes, I'm a partner at Debevoise and Plimpton.

Q. How long have you been a partner?

A. Since January 1, 1973.

Q. And in 1977 and 1978, was Debevoise and Plimpton known as Debevoise, Plimpton, Lyons and Gates?

A. Yes.

Q. In that period of time—1977 and 1978—did Debevoise, Plimpton, Lyons and Gates render services

to National Starch and Chemical Corporation in connection with its acquisition by Unilever?

A. Yes.

Q. And were you one of the attorneys who worked on the acquisition?

(p. 41) A. Yes.

Q. Can you describe what your role was in connection with the acquisition?

A. Yes. I was the partner in charge of the National Starch work.

Q. Who were the other attorneys at your firm who were involved in the acquisition?

A. There must have been at least 20 or so, but the principal ones were Oscar Ruebhausen, Phillip Winterer, Andrew Hartsell, Ken Wallach, Greg Friedrich and Paul Harbison and myself.

Q. And did there come a time when a structure for the transaction was proposed?

A. Yes.

Q. Do you recall when that was?

A. The structure for the transaction was proposed a very short time after representatives of Unilever approached Mr. Pascal and Mr. Greenwall to see whether there would be any interest in a combination.

MR. WALKER: Your Honor, if we could take just a minute—Mr. Sapinski has left the courtroom with one of his witnesses. I think it would be appropriate to halt the questioning until he returns.

THE COURT: Yes, we can go off the record.

(p. 42) (Off the record.)

BY MR. WALKER:

Q. Mr. Perell, when was it you learned of the proposal for structuring the transaction?

A. It was in early October of 1977.

Q. Do you recall what the proposal was at that time?

A. As I was told by Mr. Ruebhausen, my partner, that Mr. Pascal and Mr. Greenwall had been approached by a representative of Unilever and asked whether there was any interest on the part of the company and on the part of Mr. Greenwall for there to be a combination of National Starch with the Unilever group.

Q. Was any specific suggestion made as to the kind of structure which would result in that kind of combination?

A. Yes. The suggestion was that it would be an all cash transaction.

Q. Was there any consideration at that time as to the form in which the transaction would take place?

A. I think as reported to me, the initial contact was just a request as to whether they would be interested in an all cash deal.

Q. Was there subsequently a refinement of that proposal which led to the structuring of a transaction?

A. Yes.

(p. 43) Q. When did that occur?

A. It occurred a few days later when Mr. Greenwall reported back to the representatives of Unilever that he was not interested in an all cash deal.

MR. SAPINSKI: Your Honor, while most of this is stipulated, I do object to Mr. Perell testifying to what Mr. Greenwall told another person unless he was personally present. I think it's hearsay.

THE COURT: Is that covered in the stipulation?

MR. WALKER: Yes, it is, Your Honor. Really I'm interested in eliciting from the witness what the structure of the proposal was that was devised. That's my only interest really.

THE WITNESS: I was present at that particular conversation.

THE COURT: Generally speaking, people in their 80s aren't interested in cash deals, although I did once have a client in his 80s who was looking for deferred compensation agreements. He was an optimistic fellow.

BY MR. WALKER:

Q. As a result of the discussions among the parties, was a structure or a tentative structure agreed upon?

A. Yes.

Q. What was that structure?

(p. 44) A. Well, it was eventually—I guess the question is when are you referring to.

Q. In the period after October of 1977, following discussions with Mr. Greenwall. Was there a proposal that was made concerning the structuring of the trans-

action which would meet the requirements of all the parties?

A. Yes. One was developed shortly after Mr. Greenwall reported back that he was not interested in a cash transaction. It was suggested by Cravath that a novel structure might be worked out and we did in fact begin working on that.

Q. What was the suggestion by Cravath for the structuring of the transaction?

A. The suggestion by Cravath was to use a section of the code for the transaction which would permit less than a majority of the shareholders to enter into a tax-free reorganization. The section I believe was Section 351 and it was at that time a very novel approach, or at least it was to our firm.

Q. Do you recall approximately what point in time that proposal was made?

A. I would say it was mid October, maybe a week or so after the initial approach.

Q. And was that proposed structure the structure which was eventually adopted for the transaction?

(p. 45) A. Yes, it was.

Q. Was consideration given from time to time after that proposal as to other possible structures for the transaction?

A. Yes.

Q. And why was that?

A. Because we were never sure until a ruling was issued by the IRS that that structure would work so that we did consider alternatives.

Q. Were steps in fact taken to secure approval for the Cravath proposal?

A. Approval—I 'm not sure—

Q. Approval from the Internal Revenue Service.

A. We did eventually request a private letter ruling, yes.

Q. Prior to that time, do you recall whether there were any meetings or communications with the Internal Revenue Service to discuss the Cravath proposal?

A. Yes.

Q. Can you describe what took place before a letter ruling was requested?

A. I didn't participate personally in the meetings or the phone calls but they were reported to me by my partner Mr. Winterer.

(p. 46) MR. SAPINSKI: I object to anything that was reported as hearsay.

MR. WALKER: I'm not asking for the substance of it but certainly I think this witness is competent to testify as the corporate partner who was supervising the transaction if he to his knowledge was aware that meetings took place, without going into the substance of it.

THE COURT: He may answer.

BY MR. WALKER:

Q. To your knowledge did meetings take place in which the structure was discussed between representatives of the parties and the Internal Revenue Service?

A. I believe one meeting took place, yes.

Q. Do you recall when that meeting took place?

A. It was very early—I believe very early in November.

Q. And after that meeting with representatives of the IRS, did you meet with National Starch's directors?

A. Yes.

Q. Do you recall when you met with National Starch's directors?

A. Yes. It was after a board meeting of the directors I believe on the 7th of November of that year.

Q. Can you state generally what substance you
(p. 47) discussed with the directors following the board meeting on November 7th?

A. Yes. In general I told them of the approach and advised them of the steps that had been taken since the approach and discussed with them the duties of the board and where it was going.

Q. Did you also discuss with them the proceedings that were taking place in discussions with the Internal Revenue Service concerning the proposed structure?

A. Yes.

Q. What did you tell the directors on November 7, 1977, about their fiduciary duties and responsibilities?

A. To my recollection—I probably can't give you the exact words.

I reviewed with them the duties of directors in connection with unsolicited requests of this nature, duties of directors in connection with offers that may be made and duties of directors with respect to their obligations to stockholders in the event they were to negotiate a transaction.

Q. And what did you tell them their duties were in that regard?

A. I advised them that they had duties to ensure that a transaction—to the best of their abilities, that
(p. 48) a transaction would be fair to the shareholders and that that would involve valuations of the company, including looking forward and at present as to the value of the company.

That if a transaction went forward, and at that point we did not know whether it would go forward, but if it went forward that they would be wise to form a committee of independent directors to review the status of the transactions and to assist the board in making independent judgments, and that they use outside experts to assist them in that regard.

Q. Did you discuss with the directors at the meeting on November 7th the advisability of retaining an investment banking firm?

A. Yes.

Q. What did you tell the directors in that regard?

A. I told them as a practical matter that it would be extremely useful for the board to have a firm of outside independent investment bankers, one, to assist in the valuations of the company to ensure fairness of any transaction.

Secondly, to have the firm available in the event that matters became unfriendly—*i.e.*, either Unilever or a third party made a hostile tender offer or what we refer to as a bearhug—an unsolicited offer— so having
(p. 49) investment bankers at hand would assist us immediately if we needed help.

As a practical matter, I felt that it would be wise for them to do so, and, secondly, I told them that it was wise from a legal point of view in carrying out their fiduciary responsibilities.

I remember I was asked whether it was a requirement of law that they do so and at that time I knew of no requirement but I advised them that not getting investment bankers might be evidence that they did not carry out their responsibilities and in my judgment they ought to.

Q. Did the directors reach any decision following your discussion with them on November 7th?

A. Yes. They agreed that if the transaction was to go forward, and they were still unsure of that, but if it was decided to go forward that there be engaged an investment banking firm to work on behalf of the board.

Q. To the best of your recollection did the directors place any conditions on going forward at that time?

A. Yes. The only condition, and this was a condition which was recommended by management as well, was that we be satisfied that the structure which we were testing out at the IRS, that there be a reasonable chance of it working.

Q. And was there subsequently some com-
(p. 50) munication from the IRS that provided the satisfaction that management was looking for?

MR. SAPINSKI: Again, Your Honor, I object unless he participated in that. Otherwise, it's hearsay.

MR. WALKER: Well, I'm not asking him the substance of what was said with the IRS to the extent that he wasn't present, but the question is whether or not some form of satisfaction—he indicated that the directors had conditioned going forward on receipt of some preliminary indication of approval from the Internal Revenue Service.

I'm not asking for the truth of what the Internal Revenue Service said, but certainly the state of mind of the people who might have heard something from the Internal Revenue Service would not be hearsay.

If that led them to proceed in connection with the transaction—I'm not offering the truth of what the Internal Revenue Service said from this witness.

THE COURT: Isn't the answer to this question that the Service issued a favorable ruling?

MR. WALKER: Well, it did in fact issue a favorable ruling.

THE COURT: And isn't that all in the stipulation and we know that they did?

MR. WALKER: That is Your Honor, but I believe
(p. 51) there was a prior communication before the ruling which in fact conditioned or led the directors to believe in advance of actually receiving a ruling that a ruling would be likely and that that in fact caused them to proceed forward in terms of considering the transaction so there was a point in time before the actual receipt of the ruling which was the triggering event.

MR. SAPINSKI: Your Honor, that I believe is hearsay. It's just going through the back door of calling it state of mind.

Both Mr. Walker and I did interview the person who testified to—who participated in that conversation with the Internal Revenue Service and that person is available to testify. He's another partner at DPL&G.

I don't think it's proper that the substance of that conversation, or whatever Mr. Walker might choose to call it, be introduced through a witness who heard it from another party and who did not participate.

MR. WALKER: Again I'm not asking for the substance to be accepted for the truth of what the substance was.

THE COURT: Do we have any serious disagreement that there was some sort of indication, informal indication, before the ruling was issued that said it would be coming?

MR. SAPINSKI: Well, we have a disagreement as
(p. 52) to what was being told to them, yes, we do.

THE COURT: What is your position on this?

MR. SAPINSKI: Your Honor, I assume from what Mr. Walker is trying to elicit that he's trying to elicit in some way that the Internal Revenue Service gave some sort of a positive indication that a ruling would be issued if it were submitted and I don't believe the notes or anything else or the interviews that we've conducted indicated that, with the people who participated in the transaction.

I object to that inference being created when it is not in fact true.

MR. WALKER: Again, I'm not trying to prove what they said or what they didn't say. My object is to prove that the state of mind of those who talked with the Internal Revenue Service was such that they concluded it was reasonable to proceed forward with the transaction regardless of what was said to them.

There was some comfort that was perceived so that in their minds the—

THE COURT: In the informal discussions, your position is that the Internal Revenue Service said we will probably rule favorably on this.

MR. WALKER: That's correct.

THE COURT: And Mr. Sapinski is saying that
(p. 53) the Internal Revenue Service never said anything like that?

MR. SAPINSKI: That's correct, Your Honor.

THE COURT: Well, I guess we'll have to—it if really makes any difference, we'll have to hear from whoever heard the magic words of maybe we'll rule.

MR. WALKER: Again, Your Honor, we do not believe that magic words have any significance other

than the fact that they in turn caused the directors to proceed forward with the transaction. They provided some measure of encouragement that in fact a favorable ruling might be obtained in the future. That is the only basis for—

THE COURT: That there was a still a contingency here that they would in fact get a ruling and have a written ruling in hand before it went ahead.

MR. WALKER: Absolutely, before the transaction was completed.

THE COURT: I guess if Mr. Perell knows about that of his own knowledge he can testify. If not, we'll try and get it from somebody else.

MR. WALKER: That's all I want to find out.

THE COURT: Then we can see later whether it makes any difference anyway.

BY MR. WALKER:

Q. Did there come a time, Mr. Perell, that the directors decided to proceed in terms of considering the
(p. 54) transaction?

A. Yes.

Q. Can you tell me what led to that decision to proceed, what events?

A. I'm not sure—I don't understand this well enough to—

MR. SAPINSKI: I think I'm going to object at this point. I think I know where it's going.

MR. WALKER: Well, I think the purpose of my—

THE COURT: It seems to me that if one of his partners told him that things looked pretty good from the point of view of the Internal Revenue Service and he went ahead on the strength of that, he heard that conversation and whether the partner was making it up or not if that was the—if the words were in fact said and that's what moved it along, I don't think that's hearsay and I don't see any problem with it.

MR. SAPINSKI: I respectfully disagree, Your Honor.

THE COURT: Well, you're out of luck. I make the ruling.

THE WITNESS: That is in fact what took place. My partner did inform me that he had received sufficient comfort that he thought it was a reasonable risk for us to proceed, the only risk being, I might add, that
(p. 55) we did not want it to become public knowledge that the offer was—that the discussions were underway, but we had sufficient comfort that we decided to proceed.

BY MR. WALKER:

Q. And what happened after receipt of this encouragement? What was done next?

A. Following that, the firm of Morgan Stanley was engaged by the company for the company and the directors.

Q. By the time Morgan Stanley were retained, had the significant elements of the Cravath structure been defined?

A. Yes.

Q. Who was principally responsible for devising the terms of the preferred stock which was used in connection with the transaction?

A. Our firm and Cravath.

Q. Did Morgan Stanley play any significant role in terms of devising the terms of the preferred stock?

A. Could you clarify the word "significant?"

Q. Well, perhaps you can tell me what involvement to the best of your knowledge Morgan Stanley had in terms of working on the preferred stock which was used in connection with the transaction.

A. To my recollection they did give us some pieces of advice as to ratios, for example, on assets to stock
(p. 56) and a couple of other similar terms like that.

Q. To your knowledge what was the principal function of Morgan Stanley in connection with the transaction?

A. To value the company and to render a fairness opinion to the stockholders and to stand ready to assist in case there was a hostile offer.

Q. Mr. Perell, I would like to hand you what has been received in evidence as Joint Exhibit 26 which are a series of billing statements from your firm.

THE COURT: This is 26-Z.

BY MR. WALKER:

Q. If you could take a look at 26-Z, Mr. Perell, I'd like to ask you when Debevoise rendered its first statement for services in connection with the acquisition of National Starch's stock.

A. In March of 1978.

Q. And what period of time did that statement cover?

A. October 1 '77 through December 31 '77.

Q. How much is the bill?

A. $100,000.

Q. Was that bill subsequently paid?

A. I believe it was. I didn't receive payment myself but I believe it was.

Q. Can you describe generally the services that
(p. 57) were performed by your firm during this period?

A. Yes. I think generally they ran the gamut of the broad services one would expect in connection with a proposed combination of this type and magnitude which ran from what I would call sort of plain vanilla corporate work of advising the management and the directors of corporate structural matters under relevant law—in this case Delaware—fiduciary responsibilities to stockholders, analyzing ancillary documents, in this case spending time on the proposed structure, antitrust review, preliminary tender offer, defense work, looking at foreign laws that relate to acquisitions of international and transnational companies, looking at the securities laws aspects, both the '33 and the '34 Act.

In this case, it also involved, because of the preferred stock terms, some investment company act work. Generally just the very broad things that one does.

Q. Was any tax work or analysis performed during this period?

A. Yes.

Q. What was the tax work and analysis which was performed, generally speaking?

A. Generally speaking it related to the structure of the transaction to again afford stockholders the right to a tax-free reorganization.

(p. 58) Q. Was work done in connection with drafting of any documents during this period?

A. Yes. During this period the letter of intent was drafted and finalized. The merger agreement work began and together with that I would assume the proxy materials would also begin, and an S-I we also began.

We also worked on a request for a private letter ruling from the Internal Revenue Service and there were a few ancillary agreements relating to ordinary course of business during that period.

Q. During this period, did you have discussions with anyone other than the directors? I believe you mentioned shareholders of National Starch. Any other official at National Starch?

A. At National Starch, yes.

Q. Did you also have discussions with other law firms that were involved in connection with the transaction?

A. Yes, we had quite continual discussions with Cravath.

Q. And discussions with any representatives of Unilever?

A. Yes. They attended some meetings.

Q. Can you describe how the time records with respect to the acquisition matter were kept by your firm during the fourth quarter of 1977?

(p. 59) A. Yes. When we first learned of the transaction, I opened a new account at the firm for keeping time and disbursements which was a blind account which we refer to as acquisition suspense and give it a special number.

This was done customarily in the firm to preserve confidentiality.

Time was billed to that account until the public announcement of the negotiations at which point we opened another account under the National Starch name and billed time into that.

Q. And was any other time kept in the original account, the acquisition account which was opened?

A. I'm not sure I understand.

Q. It was all work done in connection with the acquisition, is that correct?

A. In the broad sense, yes.

Q. And how was the bill for the fourth quarter of 1977 prepared on the basis of the account that you had opened?

A. I personally reviewed the time tickets and allocated time to the National Starch bill and allocated time to an account for Mr. Greenwall and his family.

Q. Your firm represented Mr. Greenwall at the time as well as National Starch?

(p. 60) A. Yes.

Q. Can you describe how the time was in fact allocated between National Starch and Mr. Greenwall?

A. Yes, it wasn't done with precision but rather with judgment.

As I mentioned, I reviewed all of the time tickets and as I recall I believe that I charged time for one of our associates—I charged all of her time to the Greenwall account. She was a trust and estate lawyer and worked with the Greenwalls on their family matters and I believe probably all of her time was related directly to their work.

I allocated a substantial portion of the tax work done during that period to the Greenwall account and I allocated a portion of my time which I thought was reasonable in connection with the conversations that I had with the Greenwalls as well, and some of Mr. Ruebhausen's time.

Q. Do you recall what the final allocation was for the bill for the fourth quarter of 1977?

A. Yes. I believe that 100,000 was allocated to the company and 50,000 was allocated to the Greenwalls.

Q. And were the Greenwalls separately billed for the $50,000?

A. Yes, they were.

Q. And that was taken out of the National Starch
(p. 61) account and billed to the Greenwalls?

A. Yes.

Q. When was the next bill submitted to National Starch for services rendered in connection with the acquisition?

A. Looking at the exhibit and relying on that, I think it was May 10th, transmitting a bill dated May 9th.

Q. Do you recall what period of time that bill covered?

A. Yes, January 1 '78 to March 31 '78.

Q. How much was attributable to work done by your firm in connection with the acquisition during that period of time?

A. From this bill, it says 185,000.

Q. And do you recall what services were rendered during the billing period that you've just described—the first quarter of 1978?

A. My recollection is that during the first quarter of 1978 we continued working on the merger agreement, which was signed in mid March, and the preparation of the preliminary proxy materials, the S-1 for the exchange offer.

We discussed a number of ancillary agreements. We worked on stock option questions. We discussed some Securities Act problems with the Securities and Exchange Commission and did work on those, and we
(p. 62) had some further discussions with the Internal Revenue Service, I believe.

Q. Did you continue to advise the officers or directors or employees of the company during that period?

A. Yes.

Q. And was any work done in connection with the exchange offer during that period, to the best of your recollection?

A. Yes.

Q. What kind of work?

A. The merger agreement that was being prepared was a joint document consisting of a merger agreement and an exchange offer so we worked on the documents together basically and it was sent as one document. I can't really separate out the two.

Q. And was advice given to the special committee which had been formed?

A. Yes. I believe that we met monthly and kept them abreast of developments and received advice from them as to certain negotiating points.

Q. When was the next bill submitted to National Starch for work which was done in connection with the acquisition?

A. The exhibit contains one dated September 12, 1978.

Q. And what period of time did that bill cover?

A. April 1 '78 to June 30 '78.

(p. 63) Q. What portion of that bill was allocable to work done in connection with the acquisition?

A. According to the allocation attached, $105,000.

Q. And can you describe the services that were rendered during the second quarter of 1978 in connection with the acquisition?

A. Those services I think were similar to the ones that we did during the first quarter. We continued work on the documentation, continued discussions with the IRS and the SEC and everyone else that was continuing.

Q. When was the next statement which was rendered to National Starch for work done in connection with the acquisition?

A. October 19, 1978.

Q. That covered the third quarter of 1978?

A. Yes.

Q. July 1, 1978, through September 30?

A. Yes.

Q. How much of that bill was allocable to services rendered in connection with the acquisition?

A. According to the attached allocation, $100,000.

Q. What services were provided during that period?

A. During that period we finalized the proxy and exchange offer materials and assisted in their comple-
(p. 64) tion and mailing to shareholders.

We worked with proxy solicitors and began all of the work necessary to close the transaction in August

and to hold the meeting in lieu of the annual meeting to approve the transaction.

Q. Apart from the initial statement of services which was rendered to the Greenwalls that you described earlier, were any subsequent bills sent to the Greenwalls for work done in connection with the acquisition?

A. Yes, I believe there was.

Q. Do you recall how much the Greenwalls were billed after the first bill in the amount of $50,000?

A. Yes, my recollection is $15,000.

Q. Do you recall how that bill was determined?

A. Yes. My recollection is that approximately 10,000 at the time had been billed to the regular Greenwall account in connection with advice being given to them with respect to their receipt of the preferred stock, the gifting program, their foundation program, their family trusts and the like and what the plans would be with the stock and some additional estate planning, and approximately 5,000 was allocated by me out of the National Starch billing account that I felt was appropriately charged to the Greenwalls.

Q. Do you recall the kinds of matters for which
(p. 65) you provided that allocation from the National Starch account?

A. Yes, it was advice relating to duties of the controlling stockholder, advice relating to a letter agreement that he had entered into in connection with the transaction, agreeing not to dispose of the shares and to vote them in the same manner as the rest of the

stockholders, and some fair amount of time which I had to take to more closely describe to him so that he could understand the terms of the preferred stock which was an extraordinarily complicated document.

MR. WALKER: Thank you, Mr. Perell. I have no further questions at this time.

THE COURT: Cross-examine.

CROSS-EXAMINATION

BY MR. SAPINSKI:

Q. Mr. Perell, I give you the supplemental stipulation of facts. We're going to be looking at a lot of the exhibits.

Mr. Perell, I believe you identified Mr. Wallach as an associate in the corporations area who worked with you on the transaction.

A. Yes.

Q. And Mr. Winterer was a tax partner at DPL&G?

A. Yes.

(p. 66) Q. And Mr. Friedrich worked in the tax department?

A. Yes.

Q. Would it be fair to say that the role of Mr. Friedrich and Mr. Winterer related to the tax advice aspects of the billings?

A. Yes.

Q. And that advice involved the submission to the Internal Revenue Service of the request for ruling?

A. In part, yes.

Q. Would you say that would have been the major part?

A. The submission of the ruling?

Q. Yes.

A. No.

Q. What other aspects?

A. Well, in arriving at submission of a ruling, one had to do a lot of work and I don't know whether you mean it gets all rolled into the submission or separate.

Q. All the work that went into that. The answer would be yes?

A. Yes, that's a major part.

Q. And in that last quarter of 1977, was most of the work that was involved in negotiation of the structure, was that also part of the allocation that you described previously?

(p. 67) A. Most of the work? Could you rephrase it?

Q. Was the work involved in negotiating the structure of the transaction part of what you described in your fee allocation on direct.

A. To Mr. Greenwall?

Q. Yes.

A. Yes.

Q. When DPL&G began consideration of the Unilever offer that you testified to, you also testified that your colleagues and yourself considered other

ways in which an acquisition could be structured, is that correct?

A. Yes.

Q. Looking at Exhibits P and Q, would those reflect the types of considerations that DPL&G made regarding possible alternative structures?

A. This is a part of it.

Q. Would it be representative of the part that—Would it be representative of the work, the consideration of alternative structures?

A. Of the type of work that we had to do?

Q. Yes.

A. Yes.

Q. I would assume that in—Did you personally negotiate with the Cravath and other Unilever repre-
(p. 68) sentatives regarding the structure?

A. Yes.

Q. Were there a series of drafts, of proposals, that were exchanged between the parties?

A. I honestly can't remember.

Q. Look at S, T, U, Y and AA.

A. S is draft of October 21?

Q. Correct. Do they look familiar to you?

A. Yes.

Q. Would it be fair to say that those were drafts that the parties were exchanging?

A. I can't say they all were but some of them clearly were being exchanged, yes.

Q. Would it be accurate to say that the drafts exchanged between the parties would reflect what the status of the negotiations was at a particular point in time?

A. It's hard for me to say without looking at them specifically, but one would guess so ordinarily.

Q. You testified that you had a number of—you rendered a lot of advice and counseling to National Starch's board and management.

When we spoke last week, I believe you also said Mr. Greenwall—you spoke to him on a relatively regular basis regarding questions that he had and
(p. 69) would that be on a similar scale?

A. No.

Q. Was it a regular type of question?

A. I'm sorry?

Q. Was it a regular type of, you know, you got a call every other day or—

A. Frequently.

Q. In arriving at the terms of the ultimate letter of intent, was a substantial amount of time spent on the terms of the preferred stock?

A. Yes.

Q. Did the particular structure of the preferred—was it designed to appeal to a particular group of shareholders?

A. Yes.

Q. Who were they?

A. Low base shareholders.

Q. Do you recall whether Unilever's position was that they wanted as little preferred outstanding as possible?

A. I really don't remember.

Q. You testified before they wanted a cash deal.

A. They came in and asked whether a cash deal would be acceptable.

Q. Would the National Starch board of directors
(p. 70) have been required to approve a Unilever proposal that did not involve a merger?

A. I 'm not sure about being required to approve. If it was a tender offer, they might have had a duty to make a recommendation to shareholders.

Q. But as far as—In every acquisition transaction where shareholder's stock is being required in one way or another, would the board necessarily render a recommendation?

A. No, they would not necessarily render a recommendation but they would consider whether to make a recommendation.

Q. You testified previously that you did not believe that Morgan Stanley had anything to do with the structuring of the transaction. Is that correct?

A. I'm not sure that I said they had nothing to do with the structure.

Q. Why don't you tell me what you did say?

A. Pardon?

Q. Why don't you tell me in your own words what you testified to? I thought that was what you said.

A. I thought I had been asked whether they had done any substantial work and I said that they had given us some advice on ratios and some other terms of the preferred stock. I didn't say they didn't do anything. They did help.

(p. 71) Q. Did they work out the guarantees or the security for the preferred stock?

A. No, they did not.

Q. I'd like to show you four documents, exhibits which have been marked for identification as AH, AI, AJ and AK.

(The documents were marked for identification as Respondent's Exhibits AH, Al, AJ and AK.)

Do you recall we had a discussion last week about those particular drafts and in that discussion—You nodded your head. I assume that means yes.

A. Yes.

Q. And do you recall in that discussion that you said to me that those were not documents that were prepared by either Cravath or DPL&G?

A. I thought they were not prepared by our firm because they didn't look like our kind of type. I don't remember talking about Cravath but they weren't prepared by us.

Q. Do you remember a chronology of events that was prepared with respect to an inquiry by the Securities and Exchange Commission?

A. Yes.

(p. 72) Q. Can you tell me how that chronology was prepared?

A. Yes, it was prepared first by Mr. Wallach who then circulated drafts to me and to Mr. Ruebhausen and to Mr. Winterer and to the other lawyers in the firm and to relevant people at the company to be reviewed, and then it was revised and sent in to the Commission and the stock exchange.

Q. At some point subsequent to Morgan Stanley and Company being retained, we stipulated that it presented its findings to the management of National Starch.

Who specifically were they presented to, do you know?

A. I don't recall everyone that was there? I do know I was present and I believe my partner, Mr. Ruebhausen, was present. I believe Mr. Pascal was present. I don't remember the others.

Q. Do you recall if any sort of a summary of negotiation points or a statement of the company's position was prepared at that point?

A. I don't believe that was done, no.

Q. I'd like to show you AL for identification.

(A document was marked for identification as Respondent's Exhibit AL.)

(p. 73) There's some writing at the top, 12/6/77. Is that yours?

A. That would be mine, yes.

Q. Looking at that document, would that refresh your recollection as to whether any sort of a statement of negotiations points had been prepared?

A. I'm not sure it would— It's entitled negotiation points so I guess it was, yes.

Q. Do you recall why that was prepared?

A. I think it was an outline of open matters that we had to have made clear.

Q. And the date of that is December 6th?

A. That's the date that's written on it.

Q. Do you recall any role that you may have had in the preparation of that document?

A. I truly don't recall the document, although that is my writing in the upper righthand corner.

Q. After Morgan Stanley presented their findings, do you recall what those findings were?

A. Yes.

Q. Could you tell me what they were?

A. My recollection is that what they reported related to ranges of valuations for the company and what would be fair and my recollection is that they said
(p. 74) that $60 to $65 per share was probably not in the range of fair to shareholders; that 65 to 70 would be fair to shareholders, and that above 70 would be very generous.

Q. And what action was taken on that basis by the company?

A. Right then or eventually?

Q. Eventually.

A. Eventually the company asked Morgan Stanley to negotiate a price.

Q. And did they in fact negotiate a price?

A. Yes.

Q. Would you describe the negotiations?

A. Yes. I of course wasn't present but they were reported back to us by the investment bankers.

As I recall, the discussions went for a day or two between Morgan Stanley and I would guess Lazard, although I'm not sure, and at a meeting they reported back that they had negotiated a price of $70 per share. That was reported to a small group.

Morgan Stanley was told that that was not sufficient from the company's point of view and that they would have to do better and they went back and negotiated and came back with a price of 73.50.

Q. Looking at Exhibits AB through AG, do those documents reflect some of the work performed by
(p. 75) Debevoise on aspects of the Unilever acquisition transaction?

A. AB certainly does. AC is, yes. AD is an agreement that we negotiated, yes. AE was a memo. AF was part of our work. AG was part of our work.

Q. You mentioned before that there was a practical duty on the part of the board.

A. Yes.

Q. And I think we spoke last week. Could you describe what type of in-house capability for analysis was present at National Starch?

A. In terms of the practical duty of evaluating the value of the company in order to decide whether to enter into an agreement with somebody, the company didn' t feel that there was a great deal of depth within the company for that size transaction.

Q. You mentioned there were two people in the accounting department.

A. No, there are more than two people but there are two major—Two people that I knew that had a lot of sophistication in the department I think is the best way to put it.

Q. You mentioned before that you felt that—over my objection of course—that you received a sufficient comfort from— or that DPL&G received sufficient
(p. 76) comfort from the Internal Revenue Service conversation regarding the transaction for the possibility that—

A. Yes.

(A document was marked for identification as Respondent's Exhibit AO.)

Q. Looking at Exhibit AO, specifically at page four—first of all, is AO notes of yours?

A. Yes.

Q. Could you look at page four of AO?

A. Yes.

Q. Could you read the first three lines?

A. Sure. "Discussed with people at group chief levels, not branch chief. Bothered a lot of people but none would say would refuse to rule. Because of novelty would go up line, go to chief counsel, might even get to treasury. 90 to 120 days but could be longer. Said no continuity of interest requirement, representation as to no liquidation as to target into new co."

Q. Thank you. And they're notes of what?

A. I could guess.

Q. Do you have any idea?

A. I would say they're a report to me at some point about discussions with the IRS.

(p. 77) MR. SAPINSKI: I would like to move the Exhibits P through AG in the second stipulation into evidence at this time, Your Honor, as documents reflective of the work performed by the Debevoise firm and of the history of negotiation with the parties.

MR. WALKER: Your Honor, to my understanding if they are moved into evidence, they are evidence. I certainly don't agree with Mr. Sapinski's description as to whether or not they are representative of the work performed and I intend to inquire briefly of the witness as to that.

We don't have any objection as to P. We don't have any objections as to Q. R I would note is not a document prepared by Debevoise. It's a letter from Cravath. I would have no objection to it going into evidence.

S, T, U we also have no objections to. V is a letter again from Cravath, Swaine and Moore, which I don't

believe this witness has identified properly for the record so I would request that that be done before it's moved into evidence.

W, X, Y, Z, AA, AB, AC, AD, AE, AF and AG are also—we would have no objection to their admission into evidence but we do note questions as to the relevance of many of these exhibits. We do not believe that they are relevant but as I understand the proce-
(p. 78) dures followed by this court that would not be a bar. We do not share respondent's view that they are relevant to this case or any of the issues.

THE COURT: I think the relevance can be argued on brief. I haven't been trying to keep score of which ones are okay by you and which ones aren't.

Maybe this would be a good time to just ask Mr. Perell whatever you wanted to about those exhibits and then we could deal with the whole batch of them perhaps if you were then satisfied with respect to all of them. That might be the simplest way of putting them all in.

Why don't we interrupt Mr. Sapinski's cross-examination and Mr. Walker can ask Mr. Perell about these exhibits and then we can wrap those up.

VOIR DIRE EXAMINATION

BY MR. WALKER:

Q. Mr. Perell, would you be able to say that the documents that have been identified by Mr. Sapinski as exhibits to the supplemental stipulation of facts are representative of the services performed by your firm?

A. Which documents?

Q. As I understand it, it's P through AG.

A. I believe it represents some of the service.

Q. My question is are these representative—

(p. 79) A. We did do these documents in connection with the work and it reflects work that we're doing—that we did.

Q. Is it a fair representation of the totality of the services rendered by your firm?

A. I honestly couldn't tell you because I haven't read them so I don't know how deep they went.

Q. Would it be fair to say that the most that can be said is that they do reflect some services rendered by your firm in connection with the acquisition?

A. They certainly do reflect that.

Q. Turning to Exhibit V for a moment, which is a letter to yourself from Mr. James Edwards of Cravath, Swaine and Moore, do you recall having received that letter and the enclosure?

A. The notes on this are not in my handwriting but I assume I received it. I have no reason to believe I didn't.

Q. Do you recall whether or not issues were raised concerning bankability of the preferred stock?

A. Yes.

Q. And do you recall whether discussions took place with respect to that issue with Morgan Stanley?

A. I believe we had some discussions with Morgan Stanley, yes.

Q. Would you just explain briefly what that issue
(p. 80) with respect to bankability of the preferred stock was?

A. Whether the terms of the preferred stock were such that somebody who held it could pledge the stock as security for a loan.

Q. Was that one of a number of issues that was considered at the time in connection with the preferred stock?

A. It was an issue, yes, one of them.

Q. And in terms of the amount of time spent by your firm on the various issues relating to the preferred stock, would you characterize that as a large issue, a small issue?

A. A small issue.

MR. WALKER: Thank you, I have no further questions with respect to these documents, and with the caveat that I raised earlier about our views as to relevance, we have no objection as to the admission of any of these documents at this time.

THE COURT: These exhibits which I guess are Exhibit P through AG may be received and made part of the record and I'll note for the record the petitioner's objection as to relevancy which can be dealt with later on brief.

BY MR. WALKER:

Q. You testified earlier, Mr. Perell, that you had received frequent calls from Mr. Greenwall during the
(p. 81) course of the acquisition.

A. Yes.

Q. Can you tell me did he call you from time to time as representative of management of the company?

A. Sometimes.

Q. And he also called you at other times in his capacity as a shareholder of the company?

A. Yes.

Q. And when you referred in answer to Mr. Sapinski's question earlier, some of the calls were in one capacity and others were in another capacity.

Q. Yes.

MR. WALKER: Thank you. I have no further questions.

THE COURT: Thank you very much, Mr. Perell.

(Witness excused.)

Let's go off the record for a minute.

(Off the record.)

Whereupon,

ROBERT F. GREENHILL

was called as a witness and, being first duly sworn, was examined and testified as follows:

THE CLERK: Please be seated and state your name and address for the record.

(p. 82) THE WITNESS: Robert Foster Greenhill, 433 Riversville Road, Greenwich, Connecticut.

DIRECT EXAMINATION

BY MR. SAPINSKI:

Q. Mr. Greenhill, would you tell me by whom you are employed, sir?

A. Morgan Stanley and Company, an investment banking firm.

Q. And what is your position with the firm?

A. I'm a managing director.

Q. During the years 1977 and 1978, were you also managing director?

A. Managing director, yes. I was in charge of the merger department at that time.

Q. What if anything was your role in the Unilever and National Starch transaction?

A. I was the partner and managing director in charge of the transaction, sir.

Q. At the time that Morgan Stanley and Company was retained, did National Starch have a particular structure in mind or under consideration?

A. You mean in respect of the transaction?

Q. Yes.

A. Yes, they had a structure as best I recall that
(p. 83) involved cash and, in the alternate, preferred stock transaction.

Q. After Morgan Stanley and Company was retained, did representatives of Morgan Stanley meet with representatives of Unilever regarding the terms of that structure?

A. Yes.

Q. Could you explain?

A. It's been almost ten years ago. We met to understand the terms of the proposed structure. We met with Unilever and met with National Starch as well and they discussed the proposed structure.

We understood at Morgan Stanley that it offered the opportunity of a tax deferred transaction to certain shareholders who elected preferred stock, and of course the cash had the ordinary treatment in such a transaction.

Q. Did Morgan Stanley and Company work with representatives of National Starch in, quote unquote, fleshing out the details of the structure?

MR. WALKER: Your Honor, the "quote unquote"—

MR. SAPINSKI: It's just—it's a colloquial expression—to work out the details, I think would be a better word.

THE WITNESS: Yes, sir. We participated in the discussions related to that insofar as it represented
(p. 84) matters of financial significance.

BY MR. SAPINSKI:

Q. What do you mean by "matters of financial significance?"

A. In other words, we were there as financial experts and not as lawyers and insofar as they dealt with matters of the security underlying the preferred stock, the certainty with which dividends could be paid, the question of whether or not a guarantee was

employed and that sort of matter, that's what I mean by financial matters.

Q. Do you know whether Morgan Stanley assisted or rendered advice in connection with the drafting of any of the covenants of the preferred stock?

A. I'm sure that we reviewed drafts— Let me just state what our practice in that situation would be.

To review the covenants from a business point of view, financial point of view. We would not sit down and actually put pen to paper and draft the covenants. Normally lawyers for the company would be involved in those sort of efforts.

Q. During the year 1978 did Morgan Stanley Company have a fee schedule?

A. Yes, sir, we had a standard way of charging clients in transactions.

(p. 85) Q. Could you explain—I'd like you to look at Exhibit AN which we've marked for identification, the third page of AN.

A. Yes, sir.

Q. Would Exhibit AN reflect the Morgan Stanley fee schedules in an acquisition transaction, sir?

A. Yes. That would be a guideline fee schedule in a transaction. The ultimate amount of the fee would be subject to discussion with the client, but that would be a representation of the fee schedule we would expect.

Q. Had Morgan Stanley and Company represented the acquiring company—in this case

Unilever—would Morgan Stanley's fee have been calculated similarly?

A. Yes, except in the case of transactions in which we represented an acquirer as opposed to a seller. Once we identified the target, we would set the fee at a fixed aggregate amount and if the client ended up paying more we would not then increase the fee, so that technique would prevent us from having more compensation in the event the client had to pay more, but basically the fee schedule would apply as a general matter.

Q. The particular transaction involved here is something called a reverse subsidiary cash merger.

Would the Morgan Stanley fee have becn any dif-
(p. 86) ferent if the Unilever offer were in the form of a straight merger or an offer to purchase the assets of National Starch?

A. No, sir.

Q. Could you back up one second and could you explain how if there were any elements in the particular fee that was actually charged—the $2,200,000 fee—if that is broken down into elements in any way.

A. We do not break our fees down into elements except as follows. We would normally set a downside fee—for example, if we had worked on a transaction and the transaction then didn't eventuate we would have a downside fee arrangement or a retainer arrangement which would compensate us for our time.

Second, in the event we rendered—were called upon to render an opinion as to financial fairness during the course of a transaction, and if that opinion appeared in the public document which was circulated

to shareholders, and was one of the elements upon which they were to base their judgment of whether or not to vote for the transaction or accept securities in transaction, we would have a fee, a so-called exposure fee, which relates to the publicity of that opinion.

The third element would be an overall transaction fee. All of the previous elements would be subsumed
(p. 87) in the transaction fee and as a practical matter— in the case of National Starch I believe we were called upon to render an opinion. The transaction did occur so the downside fee wasn't relevant and my general point is that all these matters would be taken into account in the total.

Q. Would that total fee be called the completion fee?

A. That's one way of describing it, yes, sir.

Q. And referring to my prior question about whether the fee would have been any different if the offer were in a different form, would the completion fee still have related to the value of the transaction?

A. Yes, sir.

Q. For the fee charged would Morgan Stanley have been available to testify to the court of the value that it supported in an appraisal action brought by dissenters from the transaction?

A. Would the fee apply to testimony, expert testimony, in respect to an appraisal proceeding?

Q. Yes.

A. Yes. The only addition we would say there we charge some kind of daily fee to represent the actual

time we spent on the witness stand and preparation, but basically the same fee would apply.

Q. Would the fee that was charged by Morgan
(p. 88) Stanley have been the same in this case if Morgan Stanley had not been asked for a fairness opinion to be distributed with the proxy materials?

A. That would probably be right except you wouldn't have the element of the exposure fee in it. That is the segment of the fee that when the fairness opinion was made public was set.

What I meant by that specifically is if a proxy statement were distributed, and if our opinion were in the proxy statement, and if the shareholders voted down the transaction, a component of that fee would be charged as an exposure fee.

With that exception, the answer to your question is yes.

Q. But as I understood you to say, that element was not relevant in the completed _____

A. That element would be subsumed in the completion fee. That's correct.

Q. Had the transaction not required a fairness opinion would the completion fee have still been the same?

A. Yes.

MR. SAPINSKI: I have no further questions of Mr. Greenhill.

(p. 89) I would like to move Exhibit AN into evidence as the Morgan Stanley fee schedule.

MR. WALKER: I would prefer to ask a few questions on that before I take a position on that.

THE COURT: You may.

CROSS-EXAMINATION

BY MR. WALKER:

Q. Good morning, Mr. Greenhill. My name is Richard Walker. I represent the petitioner, National Starch and Chemical Corporation.

Mr. Sapinski asked you several questions about Exhibit AN, which I believe you have in front of you. Can you tell me what the effective date of that fee schedule is?

A. This says August 10, '78.

Q. That was not the fee schedule that in fact was used in connection with the National Starch transaction, is it, Mr. Greenhill?

A. No. I think there was an earlier letter, retainer letter, which was dated I believe either November or December of 1977. Again, it's been a long time ago since this transaction.

Q. Let me ask you to take a look at what has been marked as Joint Exhibit 12-L and ask if you can identify this as the engagement letter of Morgan Stanley in this transaction.

(p. 90) A. Yes, sir, that is the engagement letter.

Q. And that sets forth the terms of Morgan Stanley's engagement in this matter as well?

A. It describes the matters that we could be asked to work on, yes, sir.

Q. And in fact in this case Morgan Stanley was engaged to perform and render a fairness opinion, is that a fact?

A. Yes, sir.

Q. And isn't it also a fact it was Morgan Stanley's principal responsibility as investment adviser to National Starch to perform necessary analyses to evaluate Unilever's offer and to render its opinion fairness of the offer to National Starch's shareholders?

A. It was part of the engagement, yes, sir.

Q. Isn't it fair to say that that was the principal responsibility of Morgan Stanley in this transaction?

A. I think—You're characterizing it as principal. I look at the services performed in the whole transaction as really in large part inseparable, but that would be a very important element of their role.

MR. WALKER: I have no further questions. Thank you.

THE COURT: Anything further?

MR. WALKER: I object to the admission of the exhibit for several reasons. Number one, there has
(p. 91) been an actual engagement letter in this particular case. I don't see what the relevance of a fee schedule provided by Morgan Stanley after this transaction would have.

We have stipulated in paragraph 16 and paragraph 32 of the original stipulation as to what Morgan Stanley's engagement was and we have the actual engagement letter before the Court.

It seems to me that the letter which has been marked as AN simply has no relevance to this transaction.

REDIRECT EXAMINATION

BY MR. SAPINSKI:

Q. Mr. Greenhill, comparing AN to the fee schedule in the exhibit, are they consistent, sir?

A. It's essentially an abbreviated form of the same schedule as found on page four of the engagement letter.

Q. But does AN cover other size transactions, other than the anticipated—

A. Yes, it covers larger transactions, but essentially it's consistent.

MR. SAPINSKI: I believe it's consistent, Your Honor, and I would like to put it in.

THE COURT: What is your purpose of putting this in? We have an engagement letter that sets forth the services to be performed and the fee in this par-
(p. 92) ticular case and this AN is sort of a general fee schedule which seems to fit with 12-L.

What do we establish here with—

MR. SAPINSKI: I believe it assists me in my position that the fee charged as a percentage of the completed transaction makes it more appropriate that that fee be treated as a capital item rather than a deductible item, sir. That's what I'm trying to use that for.

MR. WALKER: That's exactly the danger that I thought this exhibit was going in for. We have testimony as to what Morgan Stanley did in this case, as to what services were provided, how their fee was calculated and we have an actual engagement letter and I think that should be the evidence as to the tax treatment of this transaction is in this case.

MR. SAPINSKI: Mr. Walker is also providing the Court with expert opinion regarding the business practice and a number of other aspects to try and push the fee toward the other side to a deductibility, and I believe I'm entitled to meet that in some way, Your Honor.

MR. WALKER: Well, we have expert testimony, Your Honor, about what the duties and responsibilities of directors were under Delaware law, but that is certainly unrelated to the fees charged by Morgan Stanley.

(p. 93) THE COURT: Exhibit AN—I haven't seen that one and I haven't had a chance to really study 12-L, either. Are they inconsistent in any way or do they kind of generally reflect—at least AN reflects how Morgan Stanley does business or how they charge and 12-L covers the specifics of this case?

MR. SAPINSKI: That would be correct, Your Honor.

MR. WALKER: There is also a covering letter which I think even more forthrightly underscores the fact that the fee schedule is for some transaction other than this particular transaction. It discusses possible referral and I don't think it has anything to do with this particular transaction.

MR. SAPINSKI: That was inadvertently put on—it was attached to the schedule but the schedule itself is what I was offering, Your Honor.

THE COURT: I will admit Exhibit AN and make it a part of the record for whatever you can make out of it but I think that the specific engagement letter, 12-L, is likely to be of more importance in this case.

This is the one we're talking about, not what they might have done with someone else in some other circumstances. It may be received in evidence.

(The document was marked as received as Respondent's AN.)

(p. 94) THE COURT: Any further questions?

MR. SAPINSKI: I don't have any further questions, Your Honor.

THE COURT: Thank you very much, Mr. Greenhill. (Witness excused.)

THE COURT: We'll go off the record.

(Recess.)

MR. WALKER: Our next witness will be Herbert Baumgarten.

Whereupon,

HERBERT BAUMGARTEN

was called as a witness and, having been first duly sworn, was examined and testified as follows:

THE CLERK: Please be seated and state your name and address for the record.

THE WITNESS: Herbert J. Baumgarten, 25 Rolling Hill Road, Bernardville, New Jersey.

DIRECT EXAMINATION

BY MR. WALKER:

Q. Mr. Baumgarten, would you state for the Court what your current occupation is, please?

A. I'm a corporate attorney. The position I hold is senior vice president and general counsel and secretary of National Starch and Chemical Corporation, as well as vice president and general counsel of Unilever United States.

(p. 95) Q. How long have you been employed by National Starch?

A. Approximately 23 years.

Q. How long have you held a position with Unilever?

A. A little more than a year.

Q. What positions did you hold with National Starch in the period 1977 and '78?

A. I had the position of vice president and counsel and I believe I became vice president and counsel and secretary in 1978.

Q. And you were an officer of National Starch both before and after its acquisition by Unilever, is that correct?

A. That's correct.

Q. Are you familiar with the operations of National Starch both before and after the acquisition by Unilever?

A. Yes, I am.

Q. Has the acquisition of National Starch by Unilever provided any appreciable synergy in terms of the operations of National Starch?

MR. SAPINSKI: I think we should define that term.

MR. WALKER: Let me ask a series of questions and maybe that will cure Mr. Sapinski's objection.

BY MR. WALKER:

Q. Subsequent to the acquisition of National Starch's stock by Unilever in 1978, did Unilever make
(p. 96) any changes in National Starch's board of directors?

A. No.

Q. Are you a director of National Starch?

A. Yes, I am.

Q. How long have you been a director of National Starch?

A. Somewhere around four years.

Q. How often does National Starch's board of directors meet?

A. National Starch's board of directors holds four regular board meetings a year—four regular informal board meetings a year and from time to time a special board meeting as the occasion may require.

Q. How often did the board meet prior to the acquisition?

A. The same.

Q. How many directors are currently on the board?

A. Twelve.

Q. And of those 12, how many are outside directors?

A. Five.

Q. How many outside directors were on National Starch's board prior to the acquisition?

A. I believe it was six.

Q. And are the outside directors who are presently on the board the same as those who were on the
(p. 97) board prior to the acquisition?

A. I believe only two out of the six.

Q. What has happened as some of the outside directors left the board? How have successors been selected?

A. The successors have been sought out by the senior management of National Starch and been asked to serve and subsequently been elected by the shareholders.

Q. Following the acquisition of National Starch by Unilever in 1978, did Unilever make any changes in the management of National Starch?

A. No.

Q. I'd like you to turn if you would, Mr. Baumgarten, to Exhibit 2l-U in the book in front of you, which is a proxy statement and I'll direct your attention to page seven of the proxy statement and specifically the subheading "management of the company after the merger."

A. Yes, sir.

Q. The first sentence under that subheading read, "The company has been informed by Unilever United States and holding that their present intention is to continue the management, operations and development of the company, including its subsidiaries and joint ventures, as heretofore.'

Has that in fact occurred? Has the management, operations and development of the company been con-
(p. 98) tinued as they were prior to the acquisition by Unilever?

A. Yes.

Q. And is there some sort of a shorthand term which is used to refer to that arrangement?

A. Well, I've heard reference to a treaty of autonomy or some such term.

Q. Can you describe what your understanding of that term is that is used?

A. Well, at the time the possible acquisition of National Starch by Unilever was being considered, an important consideration to the management of the company and its board of directors was the continuity of National Starch as an entity and as a successful company with a continuance of the philosophy of that company.

We were given to understand, I having been part of the management at that time, that we were more or less simply swapping approximately 3500 shareholders for one.

Q. Subsequent to the acquisition of National Starch, has Unilever made any changes in the operation of National Starch or National Starch's business?

A. None of significance.

Q. And has Unilever provided any significant technological assistance to National Starch?

MR. SAPINSKI: Could we define—

(p. 99) MR. WALKER: Well, you are certainly free to inquire on cross-examination what—I want to know in significant terms whether technological assistance has been provided by Unilever to National Starch.

THE WITNESS: No.

BY MR. WALKER:

Q. Has Unilever provided any significant financial assistance to National Starch subsequent to the acquisition?

A. No.

Q. Has Unilever provided legal, administrative or accounting services in any significant way to National Starch subsequent to the acquisition?

A. No.

Q. Prior to the acquisition of National Starch, did National Starch sell any of its products to Unilever?

A. Yes.

Q. And has it continued to do so subsequent to the acquisition?

A. Yes.

(p. 100) Q. Has there been any material increase in the volume of sales by National Starch to Unilever subsequent to the acquisition?

A. I don't have exact numbers. I'm unaware of exact numbers, but I don't believe so.

Q. Has there been any special arrangement for sale of products from National Starch to Unilever as a result of the acquisition that did not exist prior to the acquisition?

A. Well, in large measure National Starch is obliged to sell products to Unilever companies on a competitive basis with other people who supply some of the materials.

There are a few joint development projects that are in progress, pursuant to which, if they were successful, there would be a buy-sell contractual arrangement.

Aside from that, the answer to your question is no.

Q. So the arrangements that exist are done on a contractual basis, is that correct?

A. No, no. The special joint development projects that are pending with Unilever, they are to some degree pursuant to a written contract, that's correct.

They're not really very dissimilar from other joint development projects that National Starch has with some other potentially large customers.

Q. Were you involved in the amendment of the certificate of incorporation of National Starch?

A. Yes.

Q. Pursuant to which its authorized and unissued preferred stock was eliminated and its authorized common stock was reduced to 1,000 shares?

(p. 101) A. Yes.

Q. Can you explain to the Court the reason for that amendment?

A. Purely simplicity. There was no point in continuing to have some 6.5 million shares or some such number of common stock outstanding and then the preferred shares.

The certificate of incorporation was amended to provide for 1,000 shares of common stock again for purely administrative convenience and simplicity.

Q. Did the amendment have any substantive significance?

A. No.

MR. WALKER: Thank you. I have no further questions, Mr. Baumgarten.

CROSS-EXAMINATION

BY MR. SAPINSKI:

Q. Mr. Baumgarten, could you define what you mean by "significant?"

A. Well, what I was referring to, Mr. Sapinski, was the kind of joint development project, for example,

that is ongoing wherein National Starch has been asked to try to develop specific raw materials for use by Unilever companies. National Starch is engaged—is almost purely a manufacture of industrial products and a supplier of industrial products to consumer product companies like Unilever.

(p. 102) National Starch is working in a few specified areas to produce specialized raw materials that Unilever might use in its consumer products business, and to the extent that there is an interchange of information in connection with that kind of a project I suppose one could characterize it as being a technological assistance, but in the total scope of National Starch's technical endeavors Unilever really contributes practically nothing.

Q. You mentioned before the term you described as treaty of autonomy. Was that basically what National Starch was looking for in a new parent corporation?

A. It was a very important element in the selection of or the agreement to accept Unilever as a purchaser.

Q. In 1977 and 1978 when this transaction was taking place, was it your belief that there would be a technological benefit to National Starch from the acquisition?

A. Well, Mr. Sapinski, I personally was not in a position to judge. I mean I have a bit of a technical background having been trained originally as a chemical engineer, but I really personally would not have known what Unilever had to offer except that Unilever was a very large company with—I was told—quite extensive research laboratories.

Q. Who is Mr. Grubman?

A. Mr. Grubman today is a director of Unilever
(p. 103) PLC and Unilever N.V., the ultimate parent companies of the Unilever group.

Q. And back in 1977 and 1978?

A. I believe in 1978 he became president of National Starch. He eventually did become president of National Starch and then finally became chairman and chief executive officer. The chronology escapes me a little bit but it was around 1978 that he became president and prior to that he had been a group vice president or some such position.

Q. What about Mr. Caldwell?

A. Dr. Caldwell today is chairman of the executive committee of National Starch. At the time of the Unilever acquisition in 1978 I believe he was chairman of the board and chief executive officer.

Q. You said that you didn't have the technical expertise to know whether there would be a benefit. In your opinion would those people have—Would Mr. Grubman and Mr. Caldwell have had that technological expertise?

A. Well, Dr. Caldwell's career was through research. He was the research director of National Starch for many years and certainly he would have been in a better position than I was to make a judgment about that.

Quite frankly, I don't think that either he or Mr. Grubman knew exactly what Unilever had in its
(p. 104) research laboratories or in terms of its potentiality or that sort of thing.

Q. After the merger agreement was signed, Mr. Baumgarten, a number of the employees of National Starch executed employment contracts to remain in the employ of National Starch for a period of several years afterwards.

A. Yes.

Q. Do you recall that?

A. Yes

Q. You in fact were one of those employees.

A. That's correct.

Q. Did you stay on because you thought that there would be a benefit in the growth of the company?

A. No.

Q. Why did you stay on?

A. Inertia, uncertainty, no better offers.

Q. And that continues till today?

A. No, I would say that there is a great deal more certainty today than there was in 1978 about our future, our prospects, and mine in particular.

MR. SAPINSKI: No further questions. Thank you.

MR. WALKER: I have no further questions, Your Honor.

THE COURT: Thank you.

(Witness excused.)

(p. 105) MR. WALKER: The last witness, Your Honor, is Mr. Richard Sutton.

Whereupon,

RICHARD L. SUTTON

was called as a witness and, having been first duly sworn, was examined and testified as follows:

THE CLERK: Please be seated and state your name and address, please.

THE WITNESS: Richard Sutton, 1105 North Market Street, Wilmington, Delaware.

DIRECT EXAMINATION

BY MR. WALKER :

Q. Mr. Sutton, I'd like to hand you what we've marked as Petitioner's Exhibit 29 which is expert witness report prepared by yourself and I would like to know if you can identify it for the Court.

A. Yes, I can.

Q. Is that a report prepared by you?

A. Yes, it is.

MR. WALKER: Your Honor, I offer Petitioner's Exhibit 29 into evidence.

MR. MORMAN: Your Honor, respondent objects. We object basically because this report seeks to introduce state law into evidence and we contend that the
(p. 106) rule of judicial notice applies since Mr. Sutton seeks to testify about state law in a federal court.

We have prepared a short memorandum on the subject for your review.

THE COURT: I presume this is the expert witness report that was attached to your trial memo.

MR. WALKER: Yes, it is, Your Honor.

THE COURT: Objection overruled. Mr. Sutton's expert witness report may be received as Petitioner's Exhibit 29 and made a part of the record, and will constitute in substance Mr. Sutton's direct testimony, although if you want to ask him some questions or highlight anything, that's fine, but we don't need to read the whole report over.

I have the respondent's memorandum of law regarding this and I also have a memorandum in support of receiving this expert report which I received yesterday and I will look at both of those and consider what they have to say when I do my opinion.

(The document was marked and received as Petitioner's 29.)

MR. WALKER: Your Honor, I would just like to ask one or two further questions.

I would like to hand Mr. Sutton the supplemental stipulation of facts which has been presented to the
(p. 107) Court this morning.

BY MR. WALKER:

Q. Mr. Sutton, have you had an opportunity to review the supplemental stipulation of facts in this matter?

A. I have seen a copy of this document.

Q. Does anything within the supplemental stipulation of facts change any of your opinions in your expert report?

A. No, it does not.

MR. WALKER: Thank you. I have no further questions. We'll stand on Mr. Sutton's report as his direct examination and at this time I turn the witness for cross-examination.

THE COURT: Mr. Morman, do you wish to cross-examine Mr. Sutton?

MR. MORMAN: Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. MORMAN:

Q. Good afternoon, Mr. Sutton.

According to your report, you've represented a number of public companies in merger type deals over the years, is that correct?

A. That's correct.

Q. Have any of those transactions involved public companies which were subject to a friendly takeover bid through the purchase of the company's
(p. 108) shares from its shareholders? By "its shareholders," I mean the target company.

A. A friendly transaction. I should think that—I represented the Coca-Cola Company in connection with the acquisition of shares of Coca-Cola New York Bottling Company in what I think would be fairly characterized as a friendly transaction, for one.

Q. Was your representation of the acquiring or the acquired company?

A. The acquiring company.

Q. Was it a straight cash purchase of shares?

A. Yes.

Q. Would you say you've encountered such transactions on more than one occasion?

A. Yes.

Q. Would you like to elaborate at all?

A. You're asking about a straight cash merger?

Q. That's correct.

A. Yes. The acquisition of Magnavox Company. The acquisition of Great Western United. The acquisition of a company, the name of which I can't recall, that made airplanes in the midwest.

Q. In your experience, the shareholders in such situations generally sit back and let a corporate management advise them what to do with their shares, don't they?

(p. 109) A. I don't know what shareholders typically do in those circumstances.

Q. So you're saying that you're not sure.

A. I am not certain what shareholders typically do in such circumstances.

Q. In your experience, would it be fair to say that a good deal of the shareholders probably would take corporate management's advice?

A. You see, the problem that your question poses for me, if I can explain it, is it really requires me to determine what's in the mind of bodies of shareholders and I can tell you what my experience has been in connection with the numbers of persons who comment,

but I simply don't know the reasons for their doing it. I don't know whether they rely on management or not.

Q. Well, if they don't rely on management, why does management really have to make a recommendation to them?

A. Because management has an obligation to do so.

Q. Why would that obligation be imposed?

A. Because the law imposes it, at least in Delaware. The obligation is on the board of directors to make decisions with respect to the management of Delaware companies.

Q. What would the rationale behind that rule be?

A. Well, one rationale behind that certainly is (p. 110) that boards of directors are generally more informed and are better able to make judgments with respect to business affairs of the corporation than the body of stockholders are.

Q. Are you familiar with a merger structure known as a reverse subsidiary cash merger?

A. I've heard the merger in this case called that.

Q. Do I take that to be a yes?

THE COURT: I think he answered the question.

BY MR. MORMAN:

Q. In general, the purpose of structuring a merger this way is to make sure that the acquirer gets 100 percent control of the target stock, isn't it?

A. I can't answer that question. I don't know. There are many mergers in many different forms in

which you acquire 100 percent of the other company's stock.

I can't say that that's unique to this or especially important to this form.

MR. MORMAN: No further questions, Your Honor.

THE COURT: Do you have any?

MR. WALKER: We have nothing further, Your Honor.

THE COURT: Thank you, Mr. Sutton.

(Witness excused.)

MR. WALKER: Your Honor, petitioner rests.

MR. SAPINSKI: We don't have anything further, Your Honor.

(Certificate of transcriber and proofreader omitted)

[Trial Exhibit—Pages 42-43 of Ruebhausen Deposition]

undertake?

MR. MURPHY: Can I ask a question?

Was it you who personally gave the assignment to Morgan Stanley?

A. From these notes, it appears that I was the spokesman.

Q. Sir —

MR. MURPHY: What did you say to them to give them the assignment?

THE WITNESS: I have no present independent recollection of what I said to them.

Q. Bearing that in mind, sir, you said your recollection had been refreshed —

A. I am referring to the notes, "OMR advised Baldwin that the Greenwall 15 percent holdings presented estates problems, but they have been managed. Yet they present, by overhanging the market, a" — question mark — "for National Starch Corporation for the future. And advice as to a range of protective steps was desired for National Starch, particularly since an opportunity —" and I can't read — "was not before National Starch —" "particular opportunity put before National Starch."

Q. Did you or the others who attended on behalf of National Starch at that meeting, do you recall whether you gave Mr. Baldwin an oral or a written description of the structure of the transaction?

[Trial Exhibit—Pages 42-43 of Ruebhausen Deposition]

A. I do not recall having given any description to Mr. Baldwin of the structure of the transaction.

Q. Do you recall any meeting with anyone else at Morgan Stanley, at that time or shortly thereafter, in which you or anyone in your presence, where the structure was described to them?

A. I do not recall ever describing the structuring myself to Morgan Stanley.

Q. Thank you, sir.

Do you know whether Morgan Stanley after — let's back up.

Did Morgan Stanley take the assignment to represent National Starch —

MR. WALKER: Could you just rephrase it, to say did Morgan Stanley take an assignment rather than "the," it makes it

UNITED STATES TAX COURT

NATIONAL STARCH AND CHEMICAL CORP., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 31669-84 Filed July 24, 1989.

CLAPP, *Judge:* Respondent determined a deficiency in petitioner's Federal income tax for the taxable year ended August 15, 1978, in the amount of $1,068,281. The only issue for our decision is whether petitioner, the acquired corporation in a friendly takeover, may deduct under section 162(a)[1] the expenditures it incurred incident to the takeover.

FINDINGS OF FACT

Most of the facts were stipulated and are so found. The stipulation of facts and attached exhibits are incorporated herein by this reference. At the time the petition was filed, the principal office of National Starch & Chemical Corp. (petitioner) was located in Bridgewater, New Jersey.

Petitioner is a Delaware corporation which uses the accrual method of accounting for Federal income tax purposes. The tax year in issue was a short year that ran from January 1 to August 15, 1978. Petitioner manufactures and sells adhesives, starches, and specialty chemical products in the United States and certain foreign countries. Immediately prior to

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954 as amended and in effect for the year in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

August 15, 1978, petitioner's authorized capital stock consisted of 250,000 shares of preferred stock, none issued or outstanding, and 8 million shares of common stock, approximately 6,563,930 shares of which were issued and outstanding. Petitioner's common stock was publicly held by approximately 3,700 shareholders and was traded on the New York Stock Exchange. Petitioner's largest shareholder was Frank K. Greenwall (Greenwall) who, together with his wife, owned approximately 14½ percent of petitioner's outstanding common stock.

Unilever United States, Inc. (Unilever U.S.), is a Delaware corporation whose principal office is located in New York City. It is a holding company whose principal subsidiaries prior to August 15, 1978, were Lever Brothers Co. and Thomas J. Lipton, Inc. These corporations manufacture and sell foods, detergents, and other products. All of the outstanding stock of Unilever U.S. is owned by Unilever N.V., a publicly held Netherlands corporation. Unilever N.V. and Unilever PLC (a publicly held United Kingdom corporation), along with companies directly or indirectly owned or controlled by them, comprise the Unilever Group.

On October 7, 1977, representatives of the Unilever Group indicated an interest in making a tender offer for all of petitioner's stock. This interest was expressed at a meeting with the chairman of petitioner's board of directors and with Greenwall (who was chairman of the executive committee of the board of directors). In the course of the subsequent discussions, Greenwall (who was 81 years old and his wife 79 years old) indicated that for estate planning reasons he and his wife would voluntarily dispose of

their stock only in a tax-free transaction that would be available to the other shareholders. The Unilever Group said that it would proceed with the tender offer only if both Greenwall and petitioner favored the acquisition of the stock.

The law firm of Cravath, Swaine & Moore, counsel to Unilever U.S., and Debevoise, Plimpton, Lyons & Gates (Debevoise, Plimpton), counsel to petitioner and to the Greenwalls, devised a structure that was designed to satisfy Greenwall's concerns. This structure involved the formation of two new companies. One was National Starch & Chemical Holding Corp. (Holding), a Delaware subsidiary of Unilever U.S. The other, which would have only a transitory existence, was a subsidiary of Holding named NSC Merger, Inc. Pursuant to an exchange offer, Holding would exchange one share of its nonvoting preferred stock for each share of petitioner's common stock that it received from petitioner's shareholders. This transaction was intended to be tax free under section 351. Pursuant to an Agreement and Plan of Merger (merger agreement), any common stock of petitioner that was not acquired by Holding pursuant to the exchange offer would be converted into cash in a merger of NSC Merger, Inc. into petitioner. The structure of the proposed transaction was discussed with Internal Revenue Service officials in the ruling branch of the national office on November 3, 1977.

On November 7, 1977, petitioner's directors were told about the Unilever Group's interest in purchasing petitioner's stock and about the proposed structure of the transaction. At that meeting, Edward A. Perell, a partner at Debevoise, Plimpton, advised the directors that they had a fiduciary duty under Delaware law to

ensure that the proposed transaction would be fair to the stockholders. In his judgment, the directors should retain an outside independent investment banking firm which would assist in the valuation of petitioner and would be available in the event that either the Unilever Group or a third party made a hostile or unsolicited tender offer. Perell told the directors that their failure to retain such a firm might be evidence that they did not carry out their fiduciary responsibilities.

On November 14, 1977, petitioner engaged the investment banking firm of Morgan Stanley & Co. Inc. (Morgan Stanley). Morgan Stanley was retained primarily to value the stock, to render a fairness opinion, and to stand ready to assist if there was a hostile tender offer.

The Unilever Group had originally proposed a price of $65 to $70 for each share of stock in petitioner and, after valuing petitioner, Morgan Stanley informed petitioner that such a price was fair. Subsequently, Morgan Stanley held discussions with the Unilever Group's representative and was offered a price of $70. The senior executives of petitioner felt that this price was too low and told the Morgan Stanley representative that they wanted $80. Morgan Stanley conveyed this information to the Unilever Group's representative and several days later Morgan Stanley reported that the Unilever Group had offered $73.50.

On December 11, 1977, a representative of Morgan Stanley submitted to petitioner's board of directors an oral report favorably evaluating the offer. On that same date, a letter of intent relating to the acquisition of petitioner's common stock was executed by petitioner and Unilever U.S.

On March 16, 1978, the board approved the execution of the merger agreement. Under the terms of that agreement, petitioner did not have to proceed with the transaction unless the Internal Revenue Service issued a favorable private letter ruling. Such a ruling letter was issued on June 28, 1978. This ruling letter held that the formation of Holding's subsidiary, NSC Merger, Inc., and the merger of that subsidiary into petitioner (a reverse subsidiary cash merger) would be disregarded for Federal tax purposes. The transaction would be a taxable sale to those shareholders who received cash and would be tax free under section 351 to shareholders who received Holding preferred stock. When the Internal Revenue Service issued the ruling letter, it did not know that petitioner would claim a deduction for its legal fees and for its Morgan Stanley fee.

On July 10, 1978, Morgan Stanley's written fairness opinion was delivered to the board. This opinion concluded that the terms of the proposed merger agreement and related exchange offer taken as a whole were fair and equitable to petitioner's shareholders from a financial point of view.

On August 15, 1978, a special meeting of petitioner's shareholders was held at which the merger agreement was approved. Later the same day, there was a closing of both parts of the transaction pursuant to the exchange offer and the merger agreement. In the transaction, 179 of petitioner's shareholders (holding approximately 21 percent of petitioner's common stock) voluntarily exchanged their stock on a share-for-share basis for 1,313,383 shares of Holding nonvoting preferred stock with a par value of $73.50 per share. The remaining

shareholders exchanged their stock for $73.50 per share in cash. As a result of the transaction, Holding acquired all of petitioner's outstanding common stock in exchange for cash of $380,151,075 and Holding preferred stock with an aggregate par value of $96,533,650.

A Morgan Stanley report had said that petitioner's management believed that affiliation with Unilever would create the opportunity for "synergy," and petitioner's 1978 annual report had said that petitioner would benefit from the availability of the Unilever Group's enormous resources. However, petitioner's business continued as before following Holding's acquisition of its stock. Its directors and officers remained in office, and its key officers and employees executed employment contracts with it as required by the merger agreement. The Unilever Group did not make any changes in the operation of petitioner, nor did it provide petitioner with significant technological or financial assistance, nor with significant legal, administrative, or accounting services. Petitioner did not acquire any property or services from any member of the Unilever Group nor did petitioner dispose of any of its assets or property. There was no material increase in petitioner's sales to the Unilever Group. For purposes of administrative convenience and simplicity, petitioner's Certificate of Incorporation was amended to eliminate its previously authorized shares of preferred stock and to reduce the total number of its authorized shares of common stock to 1,000.

Morgan Stanley charged petitioner a fee of $2,200,000 for its services. This fee was reasonable in amount. Morgan Stanley also charged petitioner a fee

of $7,586.23 for out-of-pocket expenses and $18,000 for the legal fees of its counsel. Debevoise, Plimpton charged petitioner $490,000 for the legal services rendered by it to petitioner and its board of directors, plus out-of-pocket expenses of $15,069. The services performed by Debevoise, Plimpton included advice given petitioner and its board of directors regarding their legal rights and obligations with respect to the transaction, preparation of the Internal Revenue Service ruling request, participation in negotiations, and preparation of documents. This fee was reasonable in amount. Petitioner also incurred other expenses totalling $150,962 in connection with the transaction. These expenses were reasonable in amount and were of a type customarily incurred in connection with similar transactions.

In the Federal income tax return for the year ending in 1978, petitioner deducted the Morgan Stanley fee but did not deduct the Debevoise, Plimpton fee or the other expenses. In his notice of deficiency, respondent disallowed the Morgan Stanley fee. In the petition, petitioner contested the deficiency determined by respondent and also claimed overpayment of taxes because the Debevoise, Plimpton fee and other expenses were not deducted.

OPINION

The only issue for decision is whether petitioner, the acquired firm in a friendly takeover, is entitled to deduct under section 162(a) the expenditures it incurred incident to the takeover. To our surprise, we find that this issue is one of first impression despite the prevalence of takeovers in the modern corporate world; however, we note that two highly respected

commentators have stated, without citation of authority, that—

> The well-established rule in this area is that amounts incurred to effectuate a corporate "reorganization" (in the broad sense of a rearrangement resulting in a restructuring of the corporate entity or enterprise, even if not a technical "reorganization" as defined by section 368(a) * * * are not currently deductible as business expenses under section 162 by the person incurring such costs. [B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders, par. 5.06.2, p. 5-33 (5th ed. 1987).]

Petitioner argues that it is entitled to take the deductions because the expenditures were ordinary and necessary within the meaning of section 162(a). Respondent argues that the expenditures are nondeductible because they either were capital expenditures or were constructive distributions to the shareholders.

Section 162(a) allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." Five separate requirements must be satisfied before a deduction is allowed under this section. *Commissioner v. Lincoln Savings & Loan Association,* 403 U.S. 345 (1971). One requirement— that the expenditures be paid or incurred during the taxable year— clearly is satisfied. Respondent claims that none of the other requirements are satisfied. Those requirements are (1) that the expenditures were necessary, (2) that the expenditures were for the carrying on of a trade or business, (3) that the expenditures were ordinary, and (4) that the expenditures were current expenses, not capital expenditures.

Given our disposition of the case, we need consider only the last of these requirements.

The distinction between a deductible current expense and a nondeductible capital expenditure can, at times, be unclear. When making the distinction, it must be kept in mind that deductions are a matter of legislative grace. *New Colonial Ice Co. v. Helvering,* 292 U.S. 435 (1934). Deduction statutes must be strictly construed. *Mills Estate v. Commissioner,* 206 F.2d 244, 246 (2d Cir. 1953), revg. in part on other grounds 17 T.C. 910 (1951). The taxpayer bears the burden of showing the right to the claimed deduction. *Interstate Transit Lines v. Commissioner,* 319 U.S. 590 (1943). A deduction is not allowed just because an expenditure possesses "some characteristics different from the more commonly accepted capital expenditures * * *." *General Bancshares Corp. v. Commissioner,* 326 F.2d 712, 716 (8th Cir. 1964), affg. 39 T.C. 423 (1962), cert. denied 379 U.S. 832 (1964).

The courts have determined that a number of expenditures are capital and, thus, nondeductible. These expenditures include, among others, those incurred incident to a merger into a parent company, *Denver & Salt Lake Railway Co. v. Commissioner,* 24 T.C. 709 (1955), dismissed pursuant to stipulation 234 F.2d 663 (10th Cir. 1956); a distribution to shareholders of subscription warrants for a subsidiary's stock, *Missouri-Kansas Pipe Line Co. v. Commissioner,* 148 F.2d 460 (3d Cir. 1945), affg. a Memorandum Opinion of this Court; a distribution of stock dividends, *General Bancshares Corp. v. Commissioner, supra,* a recapitalization, *Mills Estate Inc. v. Commissioner, supra,* a corporate reorganization, *Gravois Planing Mill Co. v. Commissioner,* 299 F.2d

199, 206 (8th Cir. 1962), revg. on other grounds a Memorandum Opinion of this Court; a bankruptcy reorganization, *Bush Terminal Buildings Co. v. Commissioner,* 7 T.C. 793, 818-819 (1946); and an increase in capitalization, *Fishing Tackle Products Co. v. Commissioner,* 27 T.C. 638, 645(1957).

Relying on cases such as these, respondent argues that petitioner's expenditures are nondeductible because they were incurred incident to a recapitalization, merger, or reorganization. As evidence of a recapitalization, respondent points to the amendment of petitioner's Certificate of Incorporation that eliminated the previously authorized shares of preferred stock and reduced the total number of authorized shares of common stock to 1,000. We note, however, that this amendment was done merely for purposes of administrative convenience and simplicity. Accordingly, it is not relevant to the deductibility issue.

As evidence of a merger, respondent points to the merger of NSC Merger, Inc. into petitioner. This merger, however, was incidental to the transaction, as illustrated by the Internal Revenue Service ruling letter which stated that the merger would be disregarded. Accordingly, the merger will not cause the expenditures to be characterized as capital expenditures.

Finally, respondent argues that from the standpoint of the corporation the transaction was essentially a reorganization under section 368(a)(1)(B). Respondent acknowledges that from the standpoint of the shareholders the transaction differed significantly from a section 368(a)(1)(B) reorganization, but argues that this is unimportant since we are focusing on the

tax consequences to the corporation. We agree that the various definitions of section 368(a)(1) can be helpful when deciding whether from the corporate viewpoint an expenditure was incurred incident to a reorganization. *Bilar Tool & Die Corp. v. Commissioner,* 530 F.2d 708, 713 (6th Cir. 1976), revg. on factual grounds 62 T.C. 213 (1974). We are unwilling to hold, however, that the instant transaction is sufficiently similar to a reorganization under section 368(a)(1)(B) to cause the expenditures to be capital in nature.

Although we reject these specific arguments, we hold that the expenditures at issue are not deductible under section 162(a). We base our holding upon our judgment that petitioner's directors determined that it would be in petitioner's long-term interest to shift ownership of the corporate stock to Unilever. The expenditures in issue were incurred incident to that shift in ownership and, accordingly, lead to a benefit "which could be expected to produce returns for many years in the future." *E.I. duPont de Nemours & Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970). An expenditure which results in such a benefit is capital in nature. *E.I. duPont de Nemours & Co. v. United States, supra* at 1059; *Falstaff Beer, Inc. v. Commissioner,* 322 F.2d 744, 745-746 (5th Cir. 1963), affg. 37 T.C. 451 (1961); *Clark Thread Co. v. Commissioner,* 100 F.2d 257, 258 (3d Cir. 1938), affg. 28 B.T.A. 1128 (1933); *McDonald v. Commissioner,* 139 F.2d 400, 401 (3d Cir. 1943), affd. 323 U.S. 57 (1944). The reason for the capitalization of such expenditures is "that the purpose for which the expenditure is made has to do with the corporation's operations and betterment, sometimes with a continuing capital asset, for the duration of its existence or for the indefinite future or

for a time somewhat longer than the current taxable year, in contrast to being devoted to the income production or other needs of the more immediate present." *General Bancshares Corp. v. Commissioner, supra* at 715. "While the period of the benefits may not be controlling in all cases, it nonetheless remains a prominent, if not predominate, characteristic of a capital item." *Central Texas Savings & Loan Association v. United States,* 731 F.2d 1181, 1183 (5th Cir. 1984). Expenditures may be capital in nature even if they do not result in the acquisition or increase of a corporate asset. *General Bancshares v. Commissioner, supra* at 716. If no capital asset is acquired, it does not follow that an expenditure is deductible. *Baltimore & Ohio Railroad Co. v. Commissioner,* 29 B.T.A. 368, 372-373 (1933), affd. 78 F.2d 460 (4th Cir. 1935); *Holeproof Hosiery Co. v. Commissioner,* 11 B.T.A. 547, 556 (1928).

Our judgment that petitioner's directors determined that it would be in petitioner's long-term interest to shift ownership of the corporate stock to Unilever is based upon several factors. First, "when a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interest of the corporation and its shareholders." *Unocal Corp. v. Mesa Petroleum Corp.,* 493 A.2d 946, 954 (Del. 1985). Because petitioner's directors approved the takeover, they must have determined that it was in the best interest of petitioner and its shareholders. Second, petitioner's 1978 annual report said that petitioner would benefit from the availability of the Unilever Group's enormous resources, and Morgan Stanley said that petitioner's affiliation with Unilever would create the opportunity for "synergy." There is no evidence of an immediate benefit from the affiliation, but we believe that this is immaterial. The lack of

benefits in the short term does not imply their absence in the long term, especially given the time it takes to plan and implement significant changes in a corporation's operations. Besides, expenditures "made with the contemplation that they will result in the creation of a capital asset cannot be deducted as ordinary and necessary business expenses even though that expectation is subsequently frustrated or defeated * * *." *Union Mut. Life Ins. Co. v. United States,* 570 F.2d 382, 392 (1st Cir. 1978), *cert. denied* 439 U.S. 821 (1978); *Radio Station WBIR, Inc. v. Commissioner,* 31 T.C. 803, 813-814 (1959). Third, the very availability of the resources of Unilever was an immediate, as well as a long-term, benefit because it broadened petitioner's opportunities.

Petitioner argues for several reasons, however, that the expenditures in issue are deductible. First, it cites *Commissioner v. Lincoln Savings and Loan Association, supra* at 354, where it was said that "the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year. What is important and controlling, we feel, is that the * * * payment serves to create or enhance for [the taxpayer] what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature * * *." Petitioner accordingly argues that its expenditures are deductible because the expenditures did not create or enhance a separate and distinct additional asset. In *Lincoln Savings,* however, the Court did not address the deductibility of expenditures which do not create or enhance a separate and distinct asset. Thus, *Lincoln Savings* does not support petitioner's argument.

Petitioner next refers to several Court of Appeals cases that have cited *Lincoln Savings: Iowa-Des Moines Nat. Bank v. Commissioner,* 592 F.2d 433 (8th Cir. 1979), affg. 68 T.C. 872 (1977); *NCNB Corp. v. United States,* 684 F.2d 285 (4th Cir. 1982); *Colorado Springs National Bank v. United States,* 505 F.2d 1185 (10th Cir. 1974); and *Briarcliff Candy Corp. v. Commissioner,* 475 F.2d 775 (2d Cir. 1973). *Iowa-Des Moines Nat. Bank* merely cites *Lincoln Savings* for the proposition that a benefit with a future aspect is not controlling. The remaining cases each dealt with the narrow factual situation where a firm increased its business by, respectively, expanding a branch banking system, participating in a credit card system, and soliciting agents for the sale of candies. The court in each case held that the expenditures were ordinary and necessary expenses of doing daily business rather than capital expenditures. Each case depended on its facts, and we do not find them controlling here.

Petitioner also refers to several cases in which the "dominant aspect" of a transaction determined the deductibility of expenditures incurred incident to the transaction. These cases involved transactions with some of the characteristics of a partial liquidation and some of the characteristics of a reorganization, merger, or recapitalization. In the cases in which the partial liquidation was the "dominant aspect" of the transaction, the expenditures were held to be deductible current expenses. *Gravois Planing Mill Co. v. Commissioner,* 299 F.2d 199, 209 (8th Cir. 1962), revg. a Memorandum Opinion of this Court; *United States v. General Bancshares Corp.,* 388 F.2d 184 (8th Cir. 1968); *United States v. Transamerica Corp.,* 392 F.2d 522 (9th Cir. 1968); and *El Paso Co. v. United States,* 694 F.2d 703 (Fed. Cir. 1982). In the cases in

which the reorganization, merger, or recapitalization was the "dominant aspect," the expenditures were capital expenditures. *Mills Estate Inc. v. Commissioner,* 206 F.2d 244 (2d Cir. 1953), revg. in part on other grounds 17 T.C. 910 (1951). In one case, this Court determined that the dominant aspect was a partial liquidation and, thus, the expenditure was a deductible current expense, but the Court of Appeals held that the dominant aspect was a reorganization and, thus, the expenditure was a capital expenditure. *Bilar Tool & Die Co. v. Commissioner,* 62 T.C. 213 (1974), revd. on factual grounds 530 F.2d 708 (6th Cir. 1976).

Petitioner argues that the dominant aspect of its expenditures was the fiduciary duty its directors owed to its shareholders and, accordingly, that its expenditures are deductible because they were incurred incident to that fiduciary duty. The dominant aspect of the transaction was not the fiduciary duty. Instead, the dominant aspect was the transfer of petitioner's stock for the benefit of petitioner and its shareholders. We would let the tail wag the dog if we were to view the stock transfer as the incidental aspect and the fiduciary duty that arose from the stock transfer as the dominant aspect.

We conclude that the expenditures in issue were related more to petitioner's permanent betterment, and hence capital in nature, than to the carrying on of daily business and production of income. Thus they were not ordinary and necessary within the meaning of section 162(a) and, accordingly, they are not deductible. We need not reach respondent's alternative ar-

gument that petitioner's expenditures were constructive distributions to its shareholders.

Decision will be entered for the respondent.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 89-1923

NATIONAL STARCH AND CHEMICAL CORPORATION,

Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

Argued March 16, 1990

Decided November 13, 1990

As Amended November 28, 1990

Before: SLOVITER, BECKER, and STAPLETON,
Circuit Judges

OPINION OF THE COURT

SLOVITER, Circuit Judge.

This is an appeal by National Starch and Chemical Corporation (National Starch) from a decision of the Tax Court affirming the disallowance by the Internal Revenue Service (IRS) of the investment banking fee, legal fees and related expenses incurred by National Starch's Board of Directors in deciding whether to acquiesce in a takeover by Unilever United States, Inc.

National Starch contends that these were ordinary and necessary business expenses deductible under section 162(a) of the Internal Revenue Code. The Tax Court agreed with the Commissioner of Internal Revenue that all of the fees were nondeductible capital expenditures. This appeal presents, as far as we can tell, an issue of first impression.

I. *Facts and Procedural History*

The facts are largely undisputed and are in the record as a result of a stipulation between the parties.

In 1977, Unilever approached National Starch, one of Unilever's suppliers, to gauge its interest in being the target of a friendly takeover. All of the stock of Unilever United States, Inc. is owned by Unilever N.V. (jointly referred to as Unilever), a publicly held Netherlands Corporation.[1] Unilever was interested in increasing its United States revenues relative to its overall revenues.

Unilever expressed its interest in National Starch to, *inter alia,* Frank Greenwall, a member of National Starch's Board of Directors, who along with his wife was the largest stockholder, holding approximately 14 ½ percent of the stock. The Greenwalls decided to sell their shares to Unilever if the transaction could be arranged to be tax-free to them so that they could defer capital gains for estate planning purposes. Unilever, which was interested only in a friendly takeover,

[1] Unilever United States, Inc. is a holding company whose principal subsidiaries in 1977 were Lever Brothers Co. and Thomas J. Lipton, Inc., both of which manufacture and sell primarily foods and detergents.

would proceed only if the Greenwalls were willing to sell their shares.

To satisfy the Greenwalls, the merger was arranged as a "reverse subsidiary cash merger" under which Unilever created a subsidiary, National Starch and Chemical Holding (Holding),[2] which offered to either purchase the shares of National Starch's shareholders with money contributed by Unilever or exchange them for preferred stock of Holding. Subsequently, this arrangement received the desired ruling from the Internal Revenue Service that shareholders who exchanged National Starch stock for Holding stock could do so without adverse tax consequences.

When the plan was presented to National Starch's Board of Directors for consideration, the corporation's legal counsel advised the directors that they had a duty to ensure that the transaction "would be fair to the shareholders and that that would involve valuations of the company." App. at 91. Counsel suggested "as a practical matter that it would be extremely useful for the board to have a firm of outside independent investment bankers . . . to assist in the valuations of the company to ensure fairness of any transaction," *id.*, and that it was also wise from a legal standpoint in carrying out the Board's fiduciary duties. App. at 92. When it appeared likely that a favorable ruling would be forthcoming from the IRS, National Starch

[2] Holding then created a subsidiary, NSC Merger (Merger), which was immediately merged into National Starch. The government concedes that this merger was "an incidental aspect of the transaction that should be disregarded." Brief for Appellee at 18 n.7.

engaged Morgan Stanley & Co. (Morgan Stanley) to do a preliminary analysis, review National Starch's alternatives, make a valuation judgment after studying National Starch, render a fairness opinion, and coordinate the technical details of the merger.

Morgan Stanley prepared and delivered a report to the Board on the fairness of the offer. Unilever had originally proposed a price of $65 to $70 for each share of National Starch, which Morgan Stanley concluded was fair. Unilever thereafter offered $70 a share. National Starch's management suggested a price of $80 a share, which Morgan Stanley relayed to Unilever on the Board's behalf. Morgan Stanley thereafter reported back a Unilever offer of $73.50 a share, the price ultimately agreed upon.

After the sale of the stock, National Starch retained its former management, and it did not materially increase the sale of its products to Unilever. The management at National Starch viewed the transaction as "swapping approximately 3500 shareholders for one." App. at 141. As a matter of administrative convenience, it changed its charter to eliminate its authorized and unissued preferred stock and decreased its authorized common stock to 1,000 shares.

National Starch's tax return for the year that ended August 15, 1978 (the date of acquisition) treated the $2,225,586 Morgan Stanley fee as a deduction for an ordinary and necessary business expense under section 162(a) of the Internal Revenue Code. The IRS disallowed the deduction and issued a notice of deficiency in the amount of $1,068,281. National Starch filed a petition in the United States Tax Court contesting the disallowance. It also claimed a refund,

asserting that it had overpaid its 1978 taxes in the amount of $706,079 because it had not deducted, and was entitled to deduct, anciliary expenses which included its attorneys' fees, costs associated with the proxies, and the SEC fees which it incurred with respect to the merger plan.[3] The Tax Court upheld the disallowance by the IRS. 93 T.C. 67 (1989).

The Tax Court rejected the IRS' contention that the expenditures were nondeductible because they were incurred incident to a recapitalization, merger, or reorganization, concluding essentially that the form and structure of the transaction was selected primarily for administrative convenience. On the other hand, the Tax Court concluded that these were nondeductible capital expenditures because National Starch's directors determined that it would be in National Starch's "long-term interest to shift ownership of the corporate stock to Unilever" and "[t]he expenditures in issue were incurred incident to that shift in ownership. . . ." *Id.* at 75. Accordingly, it believed those expenditures "lead to a benefit 'which could be expected to produce returns for many years in the future.'" *Id.* (quoting *E. I. du Pont de Nemours and Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970)). Such a benefit is "capital in nature" because its purpose has to do with the corporation's betterment for the indefinite future. *Id.* The court noted that National Starch's 1978 annual report stated that it would benefit from the availability of Unilever's enormous resources, and that Morgan Stanley's report stated that National Starch's affiliation with Unilever would create the opportunity for synergy. *Id.* at 76.

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[3] A refund in excess of $257,444 is barred by the statute of limitations.

The Tax Court rejected National Starch's argument that the Supreme Court's decision in *Commissioner v. Lincoln Savings & Loan Ass'n,* 403 U.S. 345, 91 S.Ct. 1893, 29 L.Ed.2d 519 (1971), created a new test to determine deductibility under section 162(a) that looks to whether a separate and distinct additional asset is created, rather than the length of the period of the benefits. 93 T.C. at 77. It also rejected National Starch's contention that the dominant aspect of the transaction was the fiduciary duty the Board of Directors owed to the shareholders and not the transfer of the stock, finding instead that "the dominant aspect was the transfer of petitioner's stock for the benefit of [National Starch] and its shareholders." *Id.* at 78.

National Starch has appealed from the Tax Court's decision. We have jurisdiction pursuant to 26 U.S.C. § 7482. Our review of the Tax Court's construction of the Code is plenary; we review its factual findings and inferences for clear error. *Pleasant Summit Land Corp. v. Commissioner,* 863 F.2d 263, 268 (3d Cir. 1988).

II. *Ordinary and Necessary Business Expenses*

A. *Effect of Lincoln Savings*

The issue before us is whether National Starch's expenditures for investment banking and legal fees can be deducted under section 162(a) of the Internal Revenue Code as ordinary and necessary business expenses or whether they must be capitalized under section 263. Section 162 provides: "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ." 26 U.S.C. § 162(a) (1988). This provision must be interpreted in

tandem with section 263, which prohibits deductions for "[a]ny amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate." 26 U.S.C. § 263(a)(1) (1988).

The Supreme Court has enumerated five separate requirements for deductibility under section 162(a). The item must (1) be paid or incurred during the taxable year (2) for carrying on any trade or business, and (3) be an expense (4) that is "necessary" and (5) "ordinary." *Commissioner v. Lincoln Savings & Loan Ass'n,* 403 U.S. at 352, 91 S.Ct. at 1898. Only the "ordinary expense" requirement is in dispute here. The Court has stated, in somewhat circular fashion, that the principal function of the term "ordinary" is to distinguish between expenses currently deductible and capital expenditures which, if deductible at all, must be amortized over the useful life of the asset. *See Commissioner v. Tellier,* 383 U.S. 687, 689-90, 86 S.Ct. 1118, 1119-20, 16 L.Ed. 2d 185 (1966).

Tax deductions are a matter of legislative grace. *See Interstate Transit Lines v. Commissioner,* 319 U.S. 590, 593, 63 S.Ct. 1279, 1281, 87 L.Ed. 1607 (1943). Thus, the burden is on the taxpayer to show that the expenses are deductible. *See E. I. du Pont de Nemours and Co. v. United States,* 432 F.2d 1052, 1059 (3d Cir. 1970).

Before 1971, this court held that when an expenditure resulted in a benefit to the taxpayer "which could be expected to produce returns for many years in the future," the expenditure was deemed capital and therefore nondeductible. *Id.* at 1059 (legal expense in devising plan to satisfy antitrust decree which involved restructuring of the enterprise not deductible);

see also McDonald v. Commissioner, 139 F.2d 400, 401 (3d Cir. 1943) (campaign expenses not deductible as ordinary expenses because benefit sought to be derived putatively spread over ten-year term), *aff'd,* 323 U.S. 57, 65 S.Ct. 96, 89 L.Ed. 68 (1944).

National Starch argues that the legal standard employed by the Tax Court in this case, which looked to the presence of a future benefit to determine that the expenditures were ordinary and necessary business expenses, was specifically rejected by the Supreme Court in *Commissioner v. Lincoln Savings & Loan Ass'n*. It argues that *Lincoln Savings* established a new and exclusive test for distinguishing between deductible expenses and nondeductible capital expenditures under which expenses are not to be capitalized unless they result in the creation or enhancement of a separate and distinct asset.

The issue before the Supreme Court in *Lincoln Savings* was whether an additional premium required by federal statute to be paid by a savings and loan association to the Federal Savings and Loan Insurance Corporation (FSLIC) was deductible as an ordinary and necessary business expense under section 162(a). The Court accepted the distinction made by the IRS between premiums paid by Lincoln for the FSLIC's Primary Reserve, the general reserve for the expenses and insurance losses in which the insured institutions had no property interest, and its Secondary Reserve, on which those institutions were credited a return and in which they owned a pro rata share to be refunded upon termination of their insured status. Premiums paid for the Primary Reserve were deductible as ordinary and necessary expenses, but the Court held that

payments to the Secondary Reserve were nondeductible capital expenditures. The Court stated:

> [w]hat is important and controlling . . . is that the . . . payment serves to create or enhance for Lincoln what is essentially a separate and distinct additional asset and that, as an inevitable consequence, the payment is capital in nature and not an expense, let alone an ordinary expense, deductible under § 162(a) in the absence of other factors not established here.

403 U.S. at 354, 91 S.Ct. at 1899.

In the course of determining that the expenses were capital, the Court stated that "the presence of an ensuing benefit that may have some future aspect is not controlling; many expenses concededly deductible have prospective effect beyond the taxable year." *Id.* National Starch relies on this language to support its argument that expenditures which do not create or enhance a separate and distinct asset are to be treated as deductible ordinary expenditures.

We do not read *Lincoln Savings* as broadly as does National Starch. The language upon which National Starch relies does not create a new bright-line test. Although the opinion clearly holds that a payment that creates or enhances a separate asset is capital in nature, *see id.*, it does not necessarily follow that if no asset is created the expenditure is not capital in nature. The government aptly describes this argument as concluding that "because something made out of glass is fragile, all things fragile must be made out of glass." Brief for Appellee at 28 n. 13.

There is nothing in the *Lincoln Savings* opinion that announces a new test for the lower courts to apply or suggests that the Court intended to create a new standard applicable irrespective of the factual context. Although it is clear that the Court viewed the creation or enhancement of a separate and distinct asset as "important and controlling" in requiring the expense to be capitalized, the absence of such an asset is not addressed in the opinion. Further, although an incidental future benefit would plainly not be controlling, the Court does not suggest that the presence of a significant future benefit is not a legitimate factor to consider in determining deductibility.

If National Starch's interpretation were correct, the Court would have implicitly overruled without discussion its earlier precedent in which it held that expenses should be capitalized even though no separate asset was created or enhanced. *See, e.g., Deputy v. du Pont,* 308 U.S. 488, 60 S.Ct. 363, 84 L.Ed. 416 (1940) (holding nondeductible carrying charges on short sales of stock to corporation's executives made by shareholder to assist the corporation in preserving his investment). In fact, in *Lincoln Savings,* 403 U.S. at 353, 91 S.Ct. at 1898, the Court cited with approval *Welch v. Helvering*, 290 U.S. 111, 54 S.Ct. 8, 78 L.Ed. 212 (1933), a case holding that payments by a former officer of the corporation's discharged debts to strengthen his own credit and professional standing were capital outlays, even though there was no separate and distinct asset involved. Thus, the *Lincoln Savings* opinion itself undermines National Starch's interpretation.

Finally, in cases decided after *Lincoln Savings,* the Court has used tests other than the separate and

distinct asset test to determine whether expenditures should be capitalized. For example, in *United States v. Mississippi Chemical Co.,* 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed. 2d 217 (1972), decided the year after *Lincoln Savings,* the Court held that expenses associated with the acquisition of stock of the Bank of Cooperatives established by the Farm Credit Act of 1933 should be capitalized without making reference to any so-called *Lincoln Savings* test. Had it viewed *Lincoln Savings* as representing a radical shift and a new bright-line test for capitalization, it is unlikely that it would have ignored such a test the following year. Instead, the Court cited the *Lincoln Savings* precedent as support for its conclusion that "[s]ince the security is of value in more than one taxable year, it is a capital asset . . . and its cost is nondeductible." *Id.* 405 U.S. at 310, 92 S.Ct. at 915.

National Starch contends that every Court of Appeals that has faced this issue in the last eighteen years has held that where the expenses did not create or enhance a separate and distinct asset, the expenses were allowed as deductible under Section 162(a). Some Courts of Appeals have indeed construed *Lincoln Savings* to have created a new standard such as that proffered by National Starch. *See, e.g., Briarcliff Candy Corp. v. Commissioner,* 475 F.2d 775, 782 (2d Cir. 1973) (*Lincoln Savings* "brought about a radical shift in emphasis" and directs the inquiry to whether the expenditures created or enhanced what was essentially a separate and distinct asset); *see also NCNB Corp. v. United States,* 684 F.2d 285 (4th Cir. 1982) (en banc) (where expenditures of bank and its parent for metro studies, feasibility studies, and application to the Comptroller of the Currency do not create or enhance separate and identifiable assets but

instead are used by parent to continually evaluate its market position, expenditures are ordinary and necessary.).

Of course, the determination whether an expenditure is ordinary or capital is fact-specific. 6 Mertens, Law of Federal Income Taxation § 25.27 (1988). Analytically inapposite are those cases which, while reading *Lincoln Savings* differently than we do, found that there was in fact a separate asset which required the capitalization of expenditures. *See, e.g., Central Texas Savings & Loan Ass'n v. United States,* 731 F.2d 1181 (5th Cir. 1984). Moreover, the cases cited by National Starch that involved the treatment of start-up costs for expansion projects of banks, *see, e.g., Colorado Springs Nat'l Bank v. United States,* 505 F.2d 1185 (10th Cir. 1974) (initial costs for computers, credit checks, and promotional activities in connection with participation in credit card system), are distinguishable. Banks, the *NCNB* court noted, are "unique" because a substantial portion of their assets must be readily available as cash to meet depositors' claims, and their books must accurately reflect their liquidity position. 684 F.2d at 293. Therefore, it found that the requirement by the Comptroller of the Currency that national banks treat such start-up costs as current expenses was presumptively controlling, but noted that the conservative accounting policy applicable to banks differed from that applicable to certain other federally regulated industries. *Id.* at 292.

Furthermore, at least three circuits continue to look to whether an ensuing benefit was created to determine whether the expense was ordinary and necessary. *See Central Texas Savings,* 731 F.2d 1181

(5th Cir. 1984); *Iowa-Des Moines Nat'l Bank v. Commissioner,* 592 F.2d 433 (8th Cir. 1979); *Colorado Springs Nat'l Bank,* 505 F.2d 1185 (10th Cir. 1974).

In any event, our reading of the Supreme Court cases leads us to conclude that no one factor alone can control this complex decision. *See Colorado Springs Nat'l Bank,* 505 F.2d at 1192 ("[w]e find no statutory, regulatory, or decisional test which is dispositive. The issue [of the treatment of the challenged items] must be determined on the facts presented in the novel situation before us."). As Justice Cardozo noted in his oft-quoted statement about the ordinary and necessary determination:

> [h]ere . . . the decisive distinctions are those of degree and not kind. One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.

Welch, 290 U.S. at 114-15, 54 S.Ct. at 9, quoted in *Lincoln Savings,* 403 U.S. at 353, 91 S.Ct. at 1898.

We conclude that although the presence of a separate and distinct asset is sufficient to treat an expenditure creating or enhancing that asset as capital, the lack of such an asset alone does not necessarily mean that an expenditure is ordinary and necessary under section 162(a). We turn, therefore, to consider the appropriate treatment of National Starch's payments, a particularly difficult inquiry here because the expenditures at issue resulted in neither a tangible asset nor a readily identifiable intangible asset. *See Ellis Banking Corp. v. Commissioner,* 688 F.2d 1376,

1379 n.7 (11th Cir. 1982), *cert. denied,* 463 U.S. 1207, 103 S.Ct. 3537, 77 L.Ed. 2d 1388 (1983).

B. *Treatment of National Starch's Expenses*

Notwithstanding National Starch's protestations to the contrary, the common characteristic of expenses that have been found to be capital, in fact the *sine qua non* of capitalization, is the presence of a not insignificant future benefit that is more than merely incidental. The Court of Appeals' decision reversed in *Lincoln Savings* had failed to recognize that such a benefit always ensues when the expenses are used to create or enhance a capital asset. However, even post-*Lincoln Savings* cases acknowledge that the period of the benefit produced by the expenditure "remains a prominent, if not predominate, characteristic of a capital item." *Central Texas Savings,* 731 F.2d at 1183. As stated in *El[illegible]nking,* "[t]he courts have uniformly interpreted [section 263] as denying a deduction for the cost of any [illegible]-lived asset." 688 F.2d at 1379 n.5. Moreover, as we previously noted, the Supreme Court itself considered the length of time a security would be of value to the taxpayer in concluding that its acquisition costs were not deductible. *Mississippi Chemical,* 405 U.S. at 310, 92 S.Ct. at 915.

In this case, the Tax Court held that the expenditures were not deductible in light of its determination that National Starch's directors concluded that it would be in the corporation's "long-term interest to shift ownership of the corporate stock to Unilever." 93 T.C. at 75. The Tax Court found that the transaction provided at least two inherently permanent benefits to National Starch: (1) the availability of Unilever's enormous resources, and (2) the opportunity for synergy created by Unilever's affiliation with National Starch. *Id.* at 76. These are factual findings of the Tax Court which we may not overturn unless clearly erroneous. *See Pleasant Summit Land Corp.,* 863 F.2d at 268.

In its discussion of the long-term benefits to National Starch as a result of the affiliation with Unilever, the Tax Court stated that "the very availability of the resources of Unilever was an immediate, as well as a long-term, benefit because it broadened [National Starch's] opportunities." 93 T.C. at 76-77. There is ample support in the record for this finding. National Starch had assets in 1976, the year before Unilever's approach, which were in excess of $241 million, App. at 373, and its operating income was $48 million. App. at 372. Unilever was gargantuan in comparison. It had combined assets in 1976 worth close to five and a half billion dollars, App. at 667, and its operating profit was in excess of one billion dollars. App. at 665.

National Starch recognized that Unilever's sheer wealth provided it with a significant benefit. National Starch's 1978 Annual Progress Report stated that, "We will benefit greatly from the availability of Unilever's enormous resources, especially in the area of basic technology." App. at 391. Although this was written after the takeover, there is no reason why it did not equally represent the view of the Board of Directors in agreeing to the takeover.

Of additional significance to the finding of long-term benefit was the Tax Court's subsidiary finding that even though there is no evidence of an immediate benefit from the affiliation, it created the opportunity for synergy. 93 T.C. at 76. National Starch primarily

produces specialty starches, adhesives and related chemical products sold to a large number of industrial users for use in manufacturing a wide variety of consumer products and product packaging. App. at 608-14. Unilever describes itself as "one of the dozen largest businesses in the world by turnover — and the largest in consumer goods." App. at 415. The larger part of Unilever is in branded and packaged consumer goods: mainly foods, detergents, and toilet preparations. Significantly, Unilever listed other "important" activities as including chemicals, paper, plastics and packaging. *Id.*

It was undisputed that prior to the affiliation National Starch sold its products to Unilever and has continued to do so thereafter. App. at 142. National Starch emphasizes that there has been no material increase in the volume of such sales, but the Tax Court noted that "[t]he lack of benefits in the short term does not imply their absence in the long term, especially given the time it takes to plan and implement significant changes in a corporation's operations." 93 T.C. at 76.

Although Ned Bandler, Unilever's senior vice-president, testified there was no synergy "in the classic sense," App. at 70, this self-interested testimony may be discounted because it was in his company's interest to minimize the tax liabilities of National Starch. *See Riley v. General Mills, Inc.*, 346 F.2d 68, 72 (3d Cir. 1965). Moreover, Bandler admitted in the very same sentence that National Starch "was not a business that was alien to Unilever's activities." App. at 70.

Finally, as emphasized by the Tax Court, Morgan Stanley reported that the National Starch "[m]anagement also feels that some synergy may exist with the

Unilever organization given a) the nature of the Unilever chemical, paper, plastics and packaging operations . . . and b) the strong consumer products orientation of Unilever United States, Inc." App. at 624-25. National Starch's managers reported this view to Morgan Stanley before the tax consequence of the transaction was at issue. There is thus adequate evidence to support the Tax Court's findings that both Unilever's enormous resources and the possibility of synergy arising from the transaction served the long-term betterment of National Starch, and they are not clearly erroneous.

As an additional reason for nondeductibility, the Commissioner proposes that we adopt the rule that "[*a*]*ny* transaction in which a corporate taxpayer is transformed from a publicly-held corporation to a one-shareholder corporation involves an effective change in the taxpayer's corporate structure that will benefit future operations," and therefore expenses incurred with respect to such an ownership shift are capital expenditures. Appellee's Brief at 21-22 (emphasis in original). The Tax Court did not reach this issue. There is some plausibility in the Commissioner's argument that the elimination of the risk of proxy fights and shareholders' derivative suits, as well as of the costs of annual filings with the SEC and the solicitation of proxies, are long-term benefits arising from the radical change in the corporate enterprise which will last for the indefinite future. However, we need not decide whether to accept the absolute rule sought by the Commissioner. In this case, more than a mere change in corporate ownership was effected. Because the transaction entailed the affiliation of National Starch with Unilever which, as we have held above, sufficed to create the requisite long-term benefit, we

will leave for another case consideration whether the benefits of restructuring ownership alone would be sufficient to require capitalization of the fees pertinent thereto.

On the other hand, it is important to note that the Board of Directors was motivated, at least in part, by concern for the future development of National Starch in the event of the death of the Greenwalls, the company's largest stockholders, who were ages 79 and 81 at that time. Oscar M. Reubhausen, Chairman of the Board of National Starch at the time of this litigation, testified that he told Morgan Stanley that the "estates problems" concerning the Greenwalls were "overhanging the market" and represented a "question mark — 'for National Starch Corporation for the future.'" App. at 203. He thus viewed the Unilever offer as a "particular opportunity put before National Starch." App. at 203-04.

Indeed, Morgan Stanley referred to that very concern in a letter to the Board summarizing its assignment. It stated that, "We understand that National Starch is interested in having Morgan Stanley review its strategic alternatives within the context both of the longer term situation of a 15% equity ownership in National Starch which at some point will be transferred from its present individual 'founding' owners and of an evaluation of an immediate proposed business combination involving Unilever." App. at 597. It is thus evident from the record that the National Starch directors viewed the Unilever offer as a transaction that would promote the long-term betterment of the corporation.

In addition, the fact that the Tax Court rejected the Commissioner's argument that the transaction

was essentially a reorganization under section 368(a)(1)(B), for which expenditures must be capitalized, does not preclude consideration of the general rationale behind requiring capitalization of expenses for restructuring. As explained by Justice Blackmun, writing as a circuit judge (who, coincidentally, also authored *Lincoln Savings*), reorganization expenses are treated as capital because they relate to the corporation's operations and betterment into the indefinite future, as distinguished from income production or other current needs. *See General Bancshares Corp. v. Commissioner,* 326 F.2d 712, 715 (8th Cir. 1964); *see also El Paso Co. v. United States,* 694 F.2d 703, 709 (Fed. Cir. 1982) (expenses of "conception and implementation" involved in "a statutory reorganization . . . are generally to be capitalized on the theory that the altered capital structure will provide a future business benefit of intermediate duration"); *McCrory Corp. v. United States,* 651 F.2d 828, 832 (2d Cir. 1981) (reorganization expenditures, like organization expenditures, contribute to the creation of an intangible long-term asset — a change in the corporate structure for the benefit of future operations).

If capital expenditures were immediately deductible, the taxpayer's income would be distorted both in the current year and in later years when the benefits are in fact received. This policy is reflected in section 263 which expressly precludes deductions for permanent "betterments" made to increase the value of any property. In line with this analysis, the court in *Ellis Banking* held that expenses made in connection with the decision to acquire stock of another corporation were not immediately deductible because to do so would understate current net income. 688 F.2d at

1379 (function of capitalization rules is to achieve accurate measure of net income by avoiding the understatement of current income associated with immediate deductibility); *see also States Steamship Co. v. Internal Revenue Serv.*, 683 F.2d 1282, 1284 (9th Cir. 1982) (disallowing "substantial tax windfall" taxpayer sought "by bunching all the excess depreciation of three years into one year").

Although National Starch notes correctly that the fees and expenses at issue are not susceptible to depreciation or amortization because the benefit to the company has no ascertainable useful life, other courts have also concluded that section 263 requires denial of immediate deductibility in comparable situations. *See, e.g., Mills Estate v. Commissioner,* 206 F.2d 244, 246 (2d Cir. 1953) (costs of corporate reorganization not deductible even though intangible asset of "altered corporate structure" was not depreciable). In this respect, the expenses are analogous to the treatment of goodwill which is neither deductible nor depreciable until the business is sold, even though the benefits (increased profits) are obtained throughout the life of the business. *See* 5 Mertens, Law of Federal Income Taxation § 23A.141 (1985); *see also Thrifticheck Services Corp. v. Commissioner,* 287 F.2d 1 (2d Cir. 1961).

Finally, we consider whether the expenditures are deductible merely because they may have been necessary under Delaware law for the Board members to satisfy their fiduciary obligation to the shareholders. Precedent suggests otherwise. The Court in *Lincoln Savings* held that additional premium payments must be capitalized even though the governing statute required their payment by the taxpayer. 403 U.S. at 359, 91 S.Ct. at 1901. Similarly, in *du Pont,*

432 F.2d at 1059, we stated that "[t]he fact that the expenditures were involuntary . . . does not negative a requirement that they be capitalized, if they were in fact capital expenditures." *See also Woolrich Woolen Mills v. United States,* 289 F.2d 444, 448 (3d Cir. 1961) ("The involuntary nature of the expenditure . . . does not render deductible as expense an item which would otherwise be non-deductible as capital.").

In sum, we conclude that the Tax Court's finding that the opportunities that arose from the friendly takeover by Unilever created a long-term benefit to National Starch was not clearly erroneous. Its conclusion that the Morgan Stanley consulting fee, legal fees, and other related expenses incurred by National Starch are not deductible under section 162(a) of the Code is consistent with the general principles usually applied by courts in analyzing the deductibility or capitalization of corporate expenses.

III. *Conclusion*

For the reasons set forth above, we will affirm the decision of the Tax Court.